THE FREEMAN

IDEAS ON LIBERTY

What We Should Teach the Eastern Europeans

Alaska's Other Oil Spill

The Folly of Rent Control

The Investor as Hero

JANUARY 1990

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THE FREEMAN

IDEAS ON LIBERTY

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Statements from Poland

We recently received the following statement of principles from three members of the Union for Realpolitik in Breslau, Poland. We have made a few editorial changes for the sake of clarity:

"The Union for Realpolitik is a political group whose main goal is to introduce the free market economy to Poland. We believe that state property should be transferred to the private sector by stock sale. Governmental and parliamentary interference in the economy should be forbidden and secured by the Constitution. All governmental subsidies, allocations, etc. should be repealed. The socialist welfare state, which already has failed, should be liquidated. Our ideal is an independent man, not a social welfare recipient.

"Leftist demagogues, social reformers, planners, and 'enlightened' progressives should be fought ideologically and politically. Trade union activity should be allowed only under the condition that such laws as the inviolability of private ownership, freedom of work, and the prohibition against violence are respected. Taxes should be as low as possible and not progressive.

"The future educational system should be based on private schools. Compulsory school attendance and legally forced coeducation should be repealed. People should be free to found schools of all kinds with different curricula and freely chosen languages of instruction.

"A strong, modernized, and technically well-equipped army with additional military training for men (in the Swiss fashion) is a necessity in Poland's geopolitical condition. It will be the best safeguard for our independence—not peace demonstrations or friendly statements made by other countries.

"Liberty is the basis for economic development as well as for diversity of social, cultural, and intellectual life."

****

The three Poles also included a statement on the idea of a United Europe. Again, we have made a few editorial changes:

"We categorically reject the idea of a United Europe. We are for a Free Europe. That means a Europe where each country maintains its

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sovereignty, but all the impediments that hamper the free exchange of people, goods, and capital (entry visas, tariff walls, restricted freedom of settling) are repealed.

"We believe that the ideas being born in Brussels [headquarters of the EuropeanCommunity] and Strasbourg [seat of the Council of Europe] are dangerous for freedom and the peaceful development of Europe. In our opinion these ideas will lead to the leveling and bureaucratization of Europe. In this way efforts are being made to restrain the freedom movement in Europe and to spread centralism on an international scale. The idea of a United Europe will help Eurocrats, bureaucrats, lobbies, and politicians to keep and strengthen their power.

"Aiming to establish a common European government as well as armed forces is utopian and dangerous. What Europe needs is a free market economy based on private property and free competition, total freedom of trade, and the end to state intervention and planning. It is also essential that the welfare state be gradually liquidated. Each man should have the right of settling, living, and working wherever he can and wishes."

Those Who Seek Freedom

Some people fear that this country will be overpopulated and impoverished unless we close our borders, but nothing could be more untrue. Where the rights of mankind are denied, where people are chattel, where the politically powerful eat out the substance of the powerless, those places have population explosions, famines, and disease. Where people are relatively free, left to their own devices, those places have stable populations, good health, and increasing wealth. The quality of life rises and falls in proportion to liberty. People seeking freedom are achievers, not burdens.

—Bernard I. Sommer
Glenview, Illinois

Rent Control

After 46 years, rent control [in New York City] seems the normal state of affairs. Yet it's a stifling state of affairs. In the early 1920s, after World War I, rent controls were allowed to expire; apartment house construction boomed, then flickered in the early 1930s in New York and revived as the economy improved before Pearl Harbor. If there were a continuing development of new apartment houses now, more people could move up, opening apartments for families in income groups below them.

Never having seen a free housing market, today's tenants fear that without controls they will be subject to gouging and capricious eviction. They do not understand that rent control has benefited the lucky, not the needy. As the prospect for profitable ownership of apartment houses improves, the supply increases. Competition for tenants among owners controls rents more effectively than governmental regulation.

—from an editorial in the
May 30, 1989, *New York Times*.

The Freedom Philosophy

Some claim they are powerless to halt the encroachment of government, but anyone can apply the freedom philosophy by independent, personal removal from the government doles. Each should examine his life; locate his area of involvement with public funds, if any; then act according to what he has learned. Certainly we can't expect others, especially elected officials, to practice the freedom philosophy if we ourselves don't.

—Joe Ogrinc
Bratenahl, Ohio

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THE FREEMAN
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The Price of Chiminelli Seeds and Regulation Q

by James Doti

In a way, searching for the chiminelli seed was a search for my roots. That thought struck me as my great aunt, Si Annunciata, and I climbed the barren and parched hills of Brienza, Italy, to locate the rare and elusive chiminelli bush, a bush capable of producing a seed of inestimable value to those who know of it.

As we reached the crest of the hill, the incredibly thin and old but still wiry Si Annunciata pointed her gnarled finger to a bush that looked like a diseased tumbleweed. I suddenly realized I was looking for the first time at a chiminelli bush and the seeds that had given me so much sensory delight over the years. After I picked a seed and put it in my mouth, the sudden explosion of flavor unleashed memories of a bygone day.

* * * * *

It was an important family powwow. One could tell by the thoughtful and methodical way the three brothers were shelling nuts. Their children looked on with obvious pride as the three middle-aged overweight men extracted with surgical precision whole nut-meats from the rock-hard and generally impenetrable Brazil nuts.

"It's too bad the Sox lost that game to the Yankees. If they'd won, they would-a pulled within six games," said Angelo, the youngest of the three brothers.

Angelo's life revolved around the fortunes of the Chicago White Sox, or lack thereof which was generally the case. The fact that the White Sox were perpetual also-rans to the Yankees transformed Angelo's thinking pattern into a series of what-ifs.

Angelo added, "If only Yogi Berra hadn't hit that homer in the ninth . . ."

"Yea, yea, yea," Tony interrupted, "dey could-a done this, dey could-a done that, but dey never win da big ones. Forget dose bums. We have ta figure out what ta send to da old country."

Tony, the oldest of the three brothers and never one to mince words, had abruptly changed the subject to one of timely importance. It was the time of year for the family to send an annual "care" package to distant relatives in Italy. How much these relatives appreciated the castoff remnants of Italo-American consumers was unclear, but the family regularly received in return a stock of chiminelli seeds that if used with discretion was good for making a year's supply of an Italian-type pretzel called "biscotti."

It is the chiminelli seed that gives an indescribably rich and sweet flavor to the biscotti. The flavor is so intoxicating that some people have been known to recite poems and sing songs about it. An indication of the seed's value is reflected by the fact that biscotti are not conducive to family sharing; in most homes each family member is given a personal stash to hoard and ration until another batch appears.

The Brienza Connection

The source of the small black seeds that make the biscotti a food fit for the gods is our ancestral home, the southern Italian village of Brienza, the only area in the world with the proper blend of

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harsh climate and barren soil that allows the ugly chiminelli bush not only to survive but to thrive and prosper as well.

The arrival of an annual shipment of chiminelli seeds from Brienza once created quite a stir in Chicago's Little Italy when two FBI agents came to investigate several families regarding their possible involvement in drug trafficking. After each of the agents was given a bag of the chiminelli seed-laden biscotti, the case was closed.

"I have a lot of double-breasted suits I wanna get rid of," said Angelo. "What if we send 'em some of those?"

"Yea, Ange, but I can't figure what dey use dem for. They're farmers for cry'n'-out-loud," said Tony.

One of the children squirming in his chair suddenly interjected, "Hey, did they like my Slinky that you sent them last year?"

"Anthony, don't butt in when we're talkin'," said Tony, who then felt guilty for stifling his son's curiosity and offered Anthony some perfectly shelled Brazil nuts.

Tony continued, "Maybe with da earthquake an' all we should send 'em some money."

At the mention of money, the middle brother Rocco, who up to this time had devoted his full attention to a particularly resistant nut, looked up and said, "Just because they have an earthquake means all of a sudden they want our money?"

The possibility of sending money instead of goods was suggested in a recently arrived letter from Brienza that threatened it would be difficult to collect and gather the seeds that year. The contents of the letter also strongly suggested that dollars would go a long way to improving the general lot of life in Brienza, especially after an earthquake virtually leveled half the town. And though the utilitarian value of the goods included in the annual "care" package was not directly questioned, perhaps some dissatisfaction was expressed at the end of the letter when it was asked what one does with a used *Uncle Milton Ant Farm.*

"None of Your Junk"

"What if the earthquake really was as bad as they're saying?" Angelo asked and added, "If we don't send 'em money, maybe we don't get the chiminelli this year."

There was a momentary hush as the brothers contemplated this shocking possibility.

"Sure we'll get 'em," said Rocco, "wait till dey see all the baby clothes I'm gonna send."

At that point, Mama, the mother of the three brothers and matriarch of the family, walked into the dining room carrying fruit and biscotti to the table. It was obvious she had been eavesdropping. She said in Italian, "Baby clothes? Those poor people don't even have any babies. Listen, you see these biscotti? If you want any more of them, then we are going to send them money this year and none of your junk."

That pretty much decided things. While up in years and certainly not as active as she used to be, Mama still ruled in most family matters, particularly in those relating to familial relations.

Angelo broke the silence that followed Mama's pronouncement with a loud crack of a Brazil nut and an observation: "You know, if the White Sox sweep the Boston series and the Yankees lose in Detroit. . . ."

* * * * *

During the 20th century, the typical response of the Federal Reserve Board (Fed) to inflationary pressures and concomitant distortions in production caused by its own expansionary monetary policies, has been to reverse course sharply and clamp down on money growth. But because of the long and variable lag before the changes in money growth affected economic activity, the Fed would generally overcompensate for past excesses and, as a result, push the economy into a recession.

Economic cycles were therefore generated by waves of expansionary and contractionary monetary policies on the part of the Fed. These cycles were then exacerbated by government-imposed rigidities of one kind or another that constrained free market forces and had a tendency to multiply miscues on the part of the Fed and lead to more extreme cyclical activity than otherwise would have occurred. Hence, it was the Fed's disastrous manipulation of the money supply between 1929 and 1932 that precipitated the Great Depression. But other government-imposed market rigidities like the ill-conceived Hawley-Smoot Tariff of 1930 served significantly to aggravate an already desperate situation.

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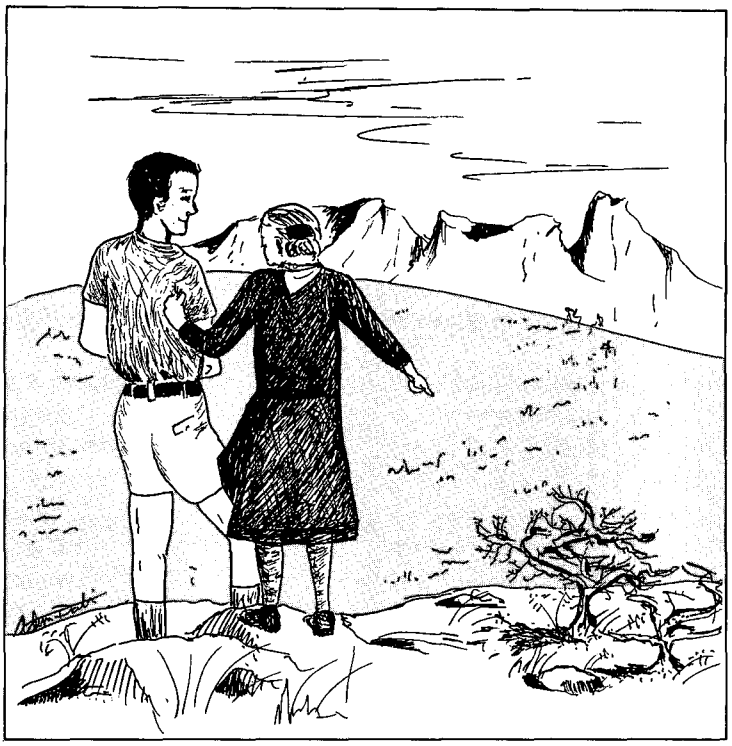

Searching for chiminelli, as drawn by Adam Doti, the author's son.

In fact, the explanation for the unprecedented longevity of our most recent business expansion is not based on the premise that the Fed or any other governmental body has become more adept at fine-tuning the economy. Quite the contrary, the absence of a recession in almost eight years is more likely related to the removal of certain government-imposed rigidities.

The Repeal of Regulation Q

Perhaps the most important but least recognized change during the deregulatory revolution of the Carter-Reagan years was the repeal of Regulation Q, a regulation that imposed interest rate ceilings on most deposit accounts at financial institutions. The repeal of Regulation Q was mandated in the Depository Institutions Deregulation and Monetary Control Act of 1980 and was carried out during the 1981-84 period by the Depository Institutions Deregulation Committee according to a timetable established by Congress. While the repeal of Regulation Q is sometimes incorrectly lamented today in discussions of the savings and loan crisis, far more significant is how its repeal has greatly benefited the macro-economy.

To compete for deposits under Regulation Q interest rate ceilings, banks and thrifts had to give away toasters, crock pots, bun warmers, and other non-monetary goods. But whenever Fed tightening pushed short-term interest rates too far above regulated levels, the various gifts being given out to retain deposits were not valuable enough to prevent an outflow of funds to other investments that were not subject to Regulation Q ceilings. At some point when the spread between market rates and Regulation Q ceilings was wide enough, people would opt for more money in the form of higher interest rates rather than gifts which ultimately turned out to be the stuff upon which future garage sales were built.

The outflow of funds from banks and thrifts, known as disintermediation, had costly economic consequences. Since banks and thrifts were the principal sources of retail credit to the housing industry, the resulting shortage of lendable funds in these institutions led to credit crunch conditions that invariably threw the construction industry into a tailspin. This process would effectively shut down a critical industry that had strong multiplier effects throughout the economy, thus making a bad situation only worse. Notice too that the

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brunt of the resulting downturn would be felt, at least initially, by those industries that were particularly sensitive to the availability of retail credit.

But now that interest-rate caps have been removed, banks and thrifts can compete effectively for deposits. Even if this competitive process pushes interest rates up during times of relative credit scarcity, such a situation is vastly preferable to a credit crunch where deposits in regulated institutions are drained away through financial disintermediation—a process that leads to conditions where lendable funds at those affected banks and thrifts are not readily obtainable even at a high price.

A recent inversion of the yield curve—where short-term interest rates exceed long-term rates—has led to ominous warnings about the economy. These warnings are based on the fact that the U.S. economy invariably moved into recessionary straits soon after such an interest-rate inversion took place. Indeed, the Chapman Econometric Model and many other models suggest that the term structure of interest rates is a better predictor of construction activity and overall economic activity than is the level of those rates.

Freeing capital markets from arbitrary interest-rate caps on bank and thrift deposits, however, has changed all this. The strong negative effect of an inverted yield curve undoubtedly was related to the fact that it served as a proxy for the outflow of funds from banks and thrifts that always occurred to some degree whenever short-term interest rates exceeded long-term rates. This process of financial disintermediation that occurred in the past because people wanted money rather than bun warmers in return for their deposits is not likely to take place in an economic environment where interest rates are allowed to move freely. Hence, the elimination of Regulation Q means that the negative consequences of an inverted yield curve are lessened and, as a result, such an inversion should be significantly discounted as a harbinger of recessionary activity.

The beauty and power of a freely moving price system should be evident here. Freer credit markets tend to lessen the ill effects of erratic Fed monetary policies. A simple change that breathes life into the economy by removing impediments to the free market system mitigates the harmful consequences brought about by knee-jerk reactions of a benevolent but woefully ill-informed Federal Reserve Board.

* * * * *

Mama's decision to send money instead of a "care" package turned out to be the right one. The veiled threats made in the letter from Brienza were not just threats. While Mama received her annual supply of chiminelli seeds soon after the family's monetary gift of $200 arrived in Brienza, other Italo-American families with relatives in Brienza received little or nothing in return for their annual shipment of castoffs. In fact, one of the families thought there might be a message in having received a Christmas wreath made of the chiminelli bush as a gift instead of the expected seeds. Evidently, the earthquake meant that it would take greenbacks rather than trinkets to entice the villagers to scavenge the barren hills of Brienza for the elusive chiminelli seeds.

* * * * *

After laboriously gathering a spoonful of seeds from that lone chiminelli bush, Si Annunciata and I climbed down the hill. By the time we reached Si Annunciata's home, perspiration stung my eyes and my clothes clung to me like pâpier-maché. As we entered the centuries-old dwelling built with two-foot walls of plaster, stone, and rock, its natural coolness invaded my senses and renewed my spirit.

I pushed several hundred dollars' worth of lira into the palm of Si Annunciata's hand. She quickly deposited the lira in her barely existent bosom. Then she kissed my cheek and brought from the cupboard a large jar full of chiminelli seeds which she tenderly placed in my hands. It was undoubtedly the largest stash I had ever seen. I caressed the jar she had given me as one might caress the Hope Diamond and felt proud that I had learned at an early age the market price of chiminelli seeds.

So let Donald Trump buy up casinos, airlines, and skyscrapers; let Queen Helmsley rule over her hotels; and let Rupert Murdoch transform the world's print and electronic media. At that moment I felt I had done something far more significant: I had cornered the market in chiminelli seeds. □

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Alaska's *Other* Oil Spill

by Stephen L. Jackstadt and Dwight R. Lee

The Exxon oil spill in the Prince William Sound of Alaska was a terrible waste. An area of enormous natural beauty was polluted, large numbers of animals were killed, and hundreds of millions of dollars have been spent on the cleanup, not to mention the loss of 11 million gallons of petroleum. Media coverage of the spill as a major event is understandable.

Yet, by far the greatest destruction of wealth associated with Alaskan oil has gone entirely unnoticed. As a direct result of the actions of the Alaskan state government, a significant portion of the net value of Alaska's petroleum reserves has been wasted just as surely as if it were being deliberately spilled into Prince William Sound. This waste continues without attracting the slightest attention from the press.

Interestingly, the explanation for governmental spillage of Alaska's oil wealth is closely tied to the explanation for the Exxon oil spill. That explanation comes from the perverse incentives resulting from the use of property that is commonly, rather than privately, owned. In the absence of well-defined private property rights to a valuable resource, no one has much incentive to exercise proper care and restraint in the use of that resource. Those who make careless and excessive use of a common property resource capture all the benefits from that use, with the costs deferred in time and diffused over the general public.

Prince William Sound is a clear example of a common property resource. It is commonly owned by the entire American public, with no one individual having either the motivation to incur a cost to protect it from abuse or the legal right to charge others for its use. Therefore, the savings the oil companies realize from exercising insufficient care in shipping oil through the Sound, or being inadequately prepared to respond to an accident, are captured completely by the oil companies. On the other hand, the environmental damage to the Sound from an oil spill will be imposed on the general public, with the oil companies being less than fully responsible for this cost.

The common property problem can also motivate wasteful oil company decisions at the northern end of the Alaskan pipeline. With several companies pumping from common petroleum pools on the North Slope, the temptation facing each is to pump as quickly as possible with little regard for the adverse effects of excessive pumping on the total petroleum that can be recovered. Each company captures all the gain from its excessive pumping, with the costs of reduced future recovery being spread over all the companies. The company that takes the long-run view by moderating its current pumping risks losing out to the excessive pumping of others.

Fortunately these common property problems are well recognized, and steps have been taken to reduce their wasteful consequences. Exxon is being required by the threat of legal action, government sanctions, and by the pressure of public opinion, to pay for much, even though not all, of the costs of its carelessness. The bearing of this cost will certainly serve as a strong incentive for Exxon, and other oil companies, to exercise more

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caution in the future. Also, the oil companies operating on the North Slope have largely solved the common property problem of excessive recovery rates by forming a consortium in which the ownership shares of the petroleum recovered from a pool are determined independently of the recovery rate, with one company making the decision on that rate.

Government Revenue as a Common Property Resource

It is widely, and correctly, recognized that government action is required if common property problems are to be adequately overcome. Government plays an important role by enforcing private property right arrangements when they emerge (as in the case of the North Slope oil fields) and by imposing sensible restrictions on the use, and penalties on the abuse, of resources when private ownership is impractical (as in the case with Prince William Sound). But what has not been widely recognized is that government is often the major source of common property problems and, as a consequence, the greatest threat to the value of our natural resources.

A significant portion of the value of natural resources goes to government in the form of royalty and severance taxes. The burden of these taxes affects how much of a resource can be recovered profitably, and the use of the tax revenue affects the value derived from the resource. And both the tax burden and the use of the tax revenue are determined in a common property setting every bit as destructive of resource wealth as any other uncontrolled common property setting.

The ownership of government revenue is not determined by well-defined property rights. Instead it is a common property resource which is allocated on the basis of political competition among various interest groups. This competition favors relatively small groups, actively organized around a narrowly focused interest which is, or can be, served by some government program.

Each of these interest groups is in a position completely analogous to that of an individual exploiting a common property resource. The interest group that manages to pump more out of the public treasury secures all of the benefits, but pays only a miniscule portion of the costs. The incentive for an interest group to moderate its demands on the public treasury for the long-run good of all is lacking completely. Such moderation will not be rewarded with reciprocal moderation on the part of other interest groups, and will be seen as a useless sacrifice. The result is a wasteful special-interest race for more government spending now, with little thought given to its long-run consequences.

Typically, special-interest waste in government spending is moderated somewhat by the resistance of the taxpaying public. The "somewhat" has to be emphasized here since taxpayers consist of such a large and diverse group of individuals with no one taxpayer likely to be heavily burdened by the costs of any particular government program. For this reason, it is difficult to mobilize taxpayers in order to resist any given program, no matter how wasteful it may be. But taxpayers are aware of their tax burdens and, without explicitly organizing, can send politicians a clear message at the polls that there are limits to the tax burdens that will be tolerated.

The Alaskan Case

In Alaska, however, taxpayers have little motivation to resist the transfer of private wealth into common property state revenue. Since the discovery of oil on Alaska's North Slope in the late 1960s, well over 80 percent of the state's tax revenue has come from taxes on oil. These taxes are paid almost entirely by consumers and investors who do not live in Alaska. Not surprisingly, fiscal restraint is an alien concept to Alaskan politicians. When faced with constituent pressures to increase spending, politicians in Juneau have seen little reason to resist. Why risk aggravating those who can vote you out of office when they can be accommodated by increasing the taxes of those who cannot?

Since 1968 the Alaskan legislature has increased taxes on oil 12 times. Even though Alaska had by far the highest taxes in the nation on oil production, the 1989 state legislature increased the state taxes on Prudhoe Bay production by 25 percent, and by about 60 percent on production out of the nearby Kuparuk oil field. The Alaskan state government is capturing over 50 percent of the net return generated by the recovery of North Slope oil, which is 70 percent more than the share received by the oil industry.

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These oil revenues are fueling state spending at unprecedented rates. Alaska is far out in front of the rest of the nation in per capita state spending. In 1986 per capita state spending in Alaska was $7,309—two-and-a-half times that of its nearest rival, Wyoming, and nearly five times the national average. The higher cost of living in Alaska can account for only a relatively small share of these differences.

The wealth contained in North Slope oil has been treated as a vast common property resource by Alaska's politicians and their special-interest clients. Predictably, the motivation has been to grab as much as possible with little worry about waste or regard for the future.

The politicians and special interests are surely aware that the oil fields are a depleting resource, and that current rates of state spending cannot long be continued. They must be aware that the long-run advantage of all would be served by reducing spending today so more could be saved to finance the continuation of reasonable spending levels in the future. Indeed, if state spending had been kept at a reasonable level over the last 20 years, that level could by now be maintained indefinitely from the interest on what would have been saved. But each special interest also knows, as does every exploiter of a common property resource, that the money it does not capture today for its spending program will instead be captured, and immediately spent, by another special interest.

Budgetary Black Holes

There is no way the Alaskan state government can spend the tremendous oil revenues on programs that make sense economically. But given the huge common property pool of oil revenues at their disposal, the politicians in Juneau are well aware that spending vast amounts on wasteful programs makes sense politically. Not surprisingly, the state of Alaska is literally spilling oil wealth throughout the state on one economic black hole after another. Consider some examples.

In 1978 the state initiated a program to promote barley farming in Alaska. Over $50 million has been spent by the state on the project, providing farmers with loans that were not repaid, building access roads to the anticipated barley fields, purchasing railroad hopper cars to transport the barley, and constructing grain elevators to store the anticipated barley production, most of which was never grown. While taking money from the state government for the purpose of growing barley, Alaskan farmers were at the same time taking money from the federal government in return for *not* growing barley. The state spent $5.8 million on a barley processing terminal in the town of Seward before halting construction. If the terminal had been completed, at a projected cost of $8.2 million, it could have processed all the barley grown in Alaska during its peak production year in 4.5 hours.

While public school students in other states are taking an occasional field trip to a nearby attraction, many Alaskan students are flying off to Europe at public expense. The Bering Strait School District, for example, received a $300,000 grant from the Alaskan Department of Education in 1980 under a program that sponsors what are known as adventure-based education projects. This grant was used to provide students with a European tour. While the $88,414 travel cost for the trip was expensive, it was less than the $106,034 spent on "consultant fees" paid to the adventure-based educational "specialists" who arranged the trip and accompanied the students to Europe.

The Alaskan state government has become an active supplier of below-cost and poorly collected loans. The Alaska Renewable Resources Corporation (ARRC) played a minor, but interesting, role in this loan activity. Established in 1978, the stated purpose of ARRC was to provide venture capital to those who attempted to utilize Alaska's renewable resources to develop such businesses as timber harvesting, seafood, fur farming, and wild berry candy. Being reluctant to discriminate against proposals just because they may be considered a bit bizarre, the ARRC has made loans for such purposes as developing dog-powered washing machines. It should come as no surprise that as of 1985, ARRC had written off $13 million in bad loans and investments, and a report by the legislative auditor classified another $16 million in loans as of "doubtful collection."

Unfortunately, ARRC loans make up only a small percentage of subsidized loans the state of Alaska uses in its effort to promote economic development. The success of Alaska's overall loan program offers little encouragement for those who see industrial planning by government as the

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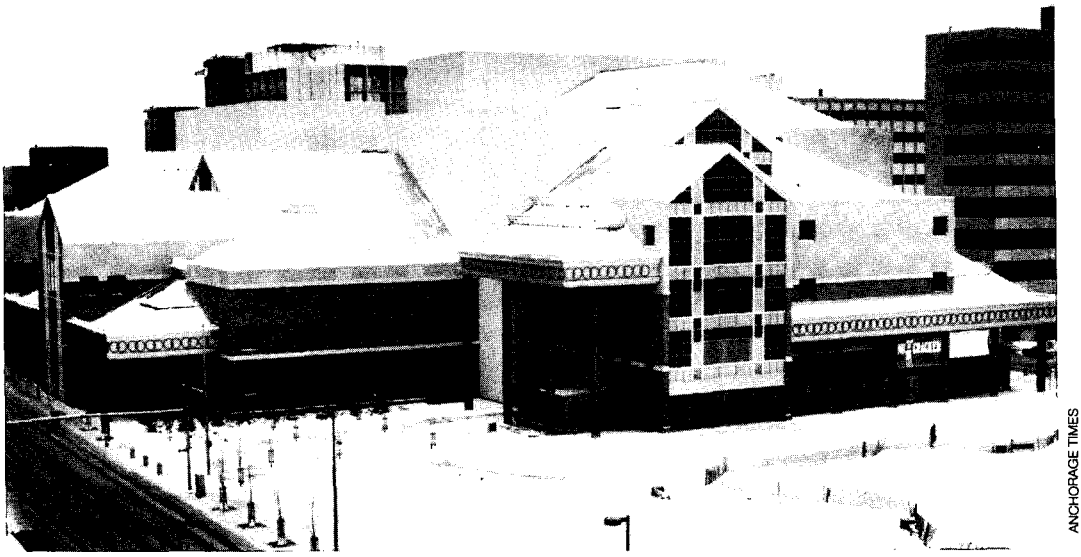

Center for the Performing Arts, Anchorage.

best way to channel investment funds to emerging growth industries. As of the end of 1987, over $233 million in loans made by the Alaskan state government were in default and another $1 billion were delinquent.

The state of Alaska has not been content to confine its industrial efforts merely to making loans. The state acquired a meat plant for $3.5 million in the mid-1980s—and it has been losing money ever since. A state-owned dairy is another financial black hole. Despite the fact that the Anchorage School District is required to purchase milk from the state dairy at a price which is 7 percent above the prevailing market price (a markup which costs the school district approximately $25,000 per year), the dairy is persistently in the red (it lost $887,000 in 1987 alone).

Performing arts centers, sports arenas, and convention centers, built in towns and cities throughout the state, do little more than stand as monuments to government extravagance and waste. An example is the $70 million performing arts center constructed with state money in Anchorage. Independent auditors say, that under the rosiest of revenue projections, the center will lose over $1 million annually. This projection considers only operating costs, ignoring completely the capital cost of the facility.

There are an almost inexhaustible number of examples that could be given of wasteful spending by the Alaskan state government. The above examples, along with the figures presented earlier on per capita state spending, are compelling evidence that the state of Alaska distinguishes itself in terms of the sheer magnitude of governmentally induced waste. When it comes to wasteful government spending, no other state in the United States can challenge Alaska.

The explanation for Alaska's wastefulness is not to be found in the venality of Alaskan politicians and officials, any more than the oil spill in Prince William Sound can be blamed on the corruption of oil industry executives. In both cases, the outcomes are the result of people responding in predictable ways to the incentives that exist in the presence of common property resources.

If there is a difference between the consequences of decisions on the transportation of petroleum by oil industry executives and decisions on the use of petroleum wealth by Alaskan politicians, it comes from the fact the former are far more subject to the constraints of public opinion than are the latter. Almost everyone is aware of the waste resulting from the Exxon oil spill, as they will be of the waste from any future spill; and this public awareness serves as a powerful incentive for the oil industry to make careful use of our oceans and waterways. Almost no one is aware of the far greater waste resulting from the political exploitation of Alaska's oil wealth. And because this Alaskan oil spill is going unnoticed by the media, and therefore by the public, the politicians responsible for it continue their improvident ways with impunity. □

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The Investor as Hero

by William B. Irvine

Recent stock market crashes have been a disaster for American investors. In the Crash of '87, they saw the aggregate value of their investments fall by $1 trillion in less than a month; and in the Friday the 13th crash of last October, their investments sustained a $200 billion loss in a single hour.

How did investors respond to these crises? For the most part, with silence. What is striking about this reaction is what investors did *not* do. They did not ask the government to return the money they had lost. They did not complain that the system had treated them unfairly. They did not ask that the markets be closed to prevent similar disasters in the future. What they did (in all but a few cases) was accept their losses as part of the price of risk-taking.

This attitude used to be common among Americans: If you take risks, you have to take an occasional loss. Although this attitude still predominates among American investors, they are unusual in this respect. More and more, Americans are willing to accept the rewards of risk-taking but not the costs. Consider some illustrations.

When several state-insured thrifts collapsed in Ohio a few years back, savers—who for years had been happy to accept the above-average interest payments of these institutions—were confronted with the downside of their risk-taking. How did they respond to their losses? They petitioned the State of Ohio to bail them out. The state was glad to comply with their request. It not only made good their losses, but let them keep the rewards (i.e., the above-average interest payments) that their years of risk-taking had earned them.

North of Los Angeles one finds a rather special breed of risk-takers: people who own million-dollar homes on Malibu Beach. There is strong evidence that Mother Nature does not want houses built on Malibu Beach. In one season she sends down boulders and mud slides to crush the houses, and in another she sends massive waves to wash them away. The residents of Malibu Beach are content to accept the rewards of their risk-taking, but no sooner are they asked to pay a price for it than they request various forms of government assistance—funded, one should note, by people who cannot afford million-dollar homes.

Farming is by its very nature a risky business, and one would assume that farmers realize as much. In this century, though, farmers have shown themselves to be far more adept at banking the profits of good years than they are at absorbing the losses of bad years. As a group, farmers are notorious for their willingness to turn to the government for subsidies in times of adversity and for their unwillingness to relinquish these subsidies when adversity is conquered. A point of interest: Five decades later, farmers are still benefiting from programs created to deal with the drought conditions of the 1930s.

Businessmen, too, have a tendency to run to the government when they gamble and lose. For years bankers have been trying to palm off their bad Third World loans onto America's taxpayers. The bankers would have resented it if, in the 1970s, a government official had advised against

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WIDE WORLD PHOTOS

A flurry of activity: Friday the 13th.

these loans or taken steps to block them; now that the loans have gone bad, these same bankers are happy to turn to government officials for advice—and, more important, for financial help.

This list could go on, but I think the point is clear. In years gone by, Americans who took risks expected to pay for their losses—and were expected to do so by the rest of us. These days, though, Americans who take risks all too often view Uncle Sam as a form of disaster insurance: When times are good, premiums cost nothing; when times are bad, claims can be filed with the media and various elected officials.

This attitude is unfortunate in two respects. First, it reveals what many would take to be a serious character flaw. If you expect freedom to do as you choose, it is only right that you should be willing to take responsibility for your actions. Likewise, those who accept praise for what they do should be also willing to accept blame. The desire to accept the rewards of risk-taking but not its costs is at best a sign of immaturity and at worst a sign of amorality.

Second, when the government has a policy—stated or unstated—of bailing out risk-takers, the economic consequences can be disastrous. If we tell risk-takers that they will have to pay the price for their miscalculations, we give them an incentive to think long and hard before taking risks and thus improve the chance that they will take only "rational" risks. If, on the other hand, we adopt policies that let them pocket their winnings and walk away from their losses, we encourage recklessness in their risk-taking. Worse still, we force taxpayers to pay for the damage caused by this recklessness.

This brings us back to the investors who were sent reeling on Black Monday in 1987, and on Friday the 13th in 1989. Taken as a group, America's 40 to 50 million investors took their losses in a matter-of-fact way. In doing so, they showed us the stuff they are made of. The silence of America's investors was not, as some might suggest, a sign of their inherent fatalism or masochism. Instead, it marks them as responsible risk-takers, a breed whose numbers have declined substantially in recent decades.

America's investors may not have emerged from the recent crashes with their nest eggs intact, but at least they emerged with their dignity intact. Not every American risk-taker can say as much. □

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The Folly of Rent Control

by James A. Maccaro

Rent control was established in New York City during World War II as an emergency measure to combat feared wartime profiteering. More than two generations later, rent control is still in place, and has inflicted more damage on the city than the war itself. As Swedish socialist economist Assar Lindbeck has written, ". . . rent control appears to be the most efficient technique presently known to destroy a city—except for bombing."[1] Anyone who seeks confirmation of this statement needs merely to tour the urban blight which sadly covers much of New York City.

The destructive effects of rent control are predicted by the laws of supply and demand. The law of supply states that the supply of a product, such as housing, will increase as the price rises; while the law of demand states that demand for a product will decrease as its price rises. These propositions would appear to be intuitive, and are illustrated countless times in the marketplace.

In the free market, supply and demand are kept in balance by the self-interest of market participants. If demand for housing increases, investors will pour capital into the market in order to reap the profits. Any attempt to take advantage of shortages by price gouging is futile, except in the very short term, because excess profits will attract other investors who will increase supply.

Legislatures cannot repeal the laws of supply and demand. Whenever prices are set by government coercion below the market-clearing level, shortages will result. Investment will evaporate as those with capital to invest will look elsewhere, rather than enter a market where the rules of the game are skewed against them. Meanwhile, demand will increase, and consumers will have to scramble to get a share of the supply that remains.

The chaotic results of rent control are clearly evident in New York, where the outcome has been a perpetual housing emergency.

The rents charged for apartments subject to government regulation are kept artificially low and frequently bear little relation to the owner's costs.[2] Any increase in rent is subject to government approval, and in a city where renters are the largest and most vocal special interest group, are only reluctantly granted. As a result, few people invest in rental housing that is subject to government regulation.

The housing shortage is further exacerbated because rent-controlled tenants, whose rents are often a fraction of their units' fair market values, are loath to relinquish their apartments. For example, New York Mayor Ed Koch has lived in a mansion provided by the taxpayers, yet has maintained a rent-controlled apartment as a second home.

Slaves of New York

Stories abound about how difficult it is to find a decent apartment in New York. A recent best-selling book and movie, *Slaves of New York* by Tama Janowitz, is based on this theme. Its main character is described as a "slave" of the city, since she lives with an abusive boyfriend because he has a lease for an apartment. If she were to end their relationship, she would have no place to live. According to the author, the ambition of "slaves" is to find an apartment of their own, which can take years, and in turn, to continue the process by acquiring their own "slaves."

A bizarre by-product of rent control in New York is "commuter leases." Finding an apartment is so difficult that people are willing to rent apartments for just nights and weekends; the rest of the time the apartment is occupied by someone else. For instance, Justin Martin, a 24-year-old who works in public relations, pays $600 a month to sublet a one-room apartment on East 49th

Mr. Maccaro, who lives in Whitestone, New York, is a free-lance writer and a law student.

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Street.[3] Under his lease, he has the right to use the apartment only on weekends and during the week from 5:00 P.M. to 9:00 A.M. The rest of the time, the apartment is used as a studio by an artist.

Fairness and Equity

The cry of those who imposed rent control was "fairness" and "equity." Yet rent control accomplishes the opposite: poor and middle-class renters and would-be renters are harmed to a disproportionate degree, while affluent tenants are in the best position to reap the benefits.

The lack of investment in housing and the low vacancy rates caused by rent control combine to create a static rental market. Those who live in poor neighborhoods cannot "move up" to better apartments because few are on the market, and those that are available are generally not within their financial reach.

Other factors work against the poor. Desirable apartment buildings usually have long waiting lists. Consequently, landlords need not publicize the availability of units, and can pick and choose their tenants. As a result, getting an apartment depends to a great extent on personal contacts and the ability to impress a landlord as a reliable tenant. Furthermore, the rent control-induced housing shortage leads to under-the-table "key money" payments to bribe landlords to lease apartments.

Apartment buildings housing low- and middle-income occupants are the hardest hit by rent control. Landlords of buildings in desirable neighborhoods catering to more affluent tenants can more easily raise the rents on vacant units to counterbalance the low rents charged on the other apartments in these buildings. In addition, they are encouraged to maintain their properties by the prospect of converting them to condominium or co-operative ownership. Landlords in lower-income sections of the city don't have these incentives. Rather, they are faced with the prospect of continuing losses and eventual bankruptcy. For this reason, more than 500,000 apartment units have been abandoned in the city, destroying entire neighborhoods and severely decreasing the housing stock available to the poor and middle class.

Winners and Losers

While there are losers as a result of rent control, there are also winners. Rent control creates a privileged special-interest group, namely, those who have leases on desirable apartments. Since rent increases don't match increases in costs, and bear no relationship to the market value of the apartment, tenants who remain in their units rather than relocate will find that, after a short number of years, they are paying a fraction of the true value of their units.

Under rent control, a lease becomes, in effect, an investment. As such, it has an economic value. For instance, "vacate" or "move-out" fees paid by landlords to tenants are common. A few years ago, a New York landlord offered his tenants $15,000 for each room of their apartments if they would move out so that he could convert the building to a condominium. Incredibly, the tenants' association sued the landlord in order to get an injunction against the offer, claiming that it was an illegal attempt to subvert tenant solidarity.[4]

The effects of rent control have been disastrous. Politicians who refuse to recognize this, and support rent control to garner votes, add to the problems of the urban homeless and the deterioration of the quality of life in our nation's cities. To achieve the goals of an efficient and equitable supply of housing, the free market must be allowed to function. The free market will permit all consumers of housing to make rational decisions on a level playing field. The alternative of government intervention protects a select few and distorts the housing supply, resulting in chaos. □

1. Assar Lindbeck, *The Political Economy of the New Left* (New York: Harper and Row, 1972), p. 39.

2. In Santa Monica, California, for instance, rent increases have been set at about two-thirds the rate of inflation. Marc Beauchamp, "Bankrupt Landlords in Wonderland," *Forbes*, March 20, 1989, pp. 105-107.

3. Mr. Martin's strange plight is described in an article in *The Wall Street Journal* by Jeffrey A. Trachtenberg entitled "And for the Summer, He's Rented Sunday Mornings at a Beach House," April 11, 1989, p. B1.

4. The courts rejected the tenant group's claims, *Karpf* v. *Turtle Bay*, 127 Misc.2d 154, 485 N.Y.S.2d 173 (1984).

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Lessons in Liberty: Hong Kong, "Crown Jewel" of Capitalism

by Robert A. Peterson

For over 100 years, the name Hong Kong has been synonymous with free enterprise. Today, the label "Made in Hong Kong" can be found just about anywhere, from clothing stores in Manhattan to gift shops in London, as the raw materials of the world are turned into finished products in Hong Kong's busy shops. To millions of tourists, Hong Kong beckons as one of the world's most alluring bargain counters. Here Swiss watches—at less than Swiss prices—compete with duty-free Japanese cameras and stereo equipment, and silks from Thailand glow beside bolts of Italian cloth and Harris tweed. As a result, little Hong Kong enjoys one of the highest standards of living in all Asia, second only to Japan and perhaps Singapore.

In 1987, Hong Kong—with 14 times as many people per square mile as Japan—had a per capita income of $8,260. Just a few miles away, across the Sham Chun River—in Communist China—people of the same racial stock, living in the same subtropical climate on shores washed by the same South China Sea, were able to produce a per capita income of only $300. (Incredibly, even some of that paltry sum was fueled by Hong Kong's economy, which both invests in and purchases from the mainland.)

What is it that has turned what a skeptical Lord Palmerston, in the 19th century, called "a barren rock" into such an economic powerhouse? What is it that has made this tiny Crown Colony (now a dependency) of the British Empire into one of the "Asian dragons" feared by protectionists in the world's largest nations?

The answer, pure and simple, is free market economics and limited government. Throughout most of its history, Hong Kong has had no tariffs or other restraints on international trade. It has had virtually no government direction of economic activity, no minimum wage laws, no fixing of prices, and no capital gains taxes. Despite some government intervention—in building public housing for refugees from Communist China—the British officials who govern Hong Kong have confined their role to that of umpire. They enforce the rules of the game, but do not help one side or another gain an economic advantage. As a result of these laissez-faire policies, Hong Kong has flourished.

The story of how Hong Kong came to be the "emporium of the East" is a fascinating tale of how limited government and free markets have combined to elevate one corner of China far above all the rest. In that history also lie insights for other nations whose greater resources have remained untapped because of socialistic economic policies. Now, when the world is on the verge of losing this modern exemplar of free markets and limited government—its sovereignty is scheduled to be transferred to Communist China in 1997—it is important to understand the forces

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that made Hong Kong what it is today. For unless right action is taken—action consistent with its history of limited government and free enterprise—Hong Kong's free-wheeling, highly creative society will be no more.

Throughout most of Chinese history, the island of Hong Kong and the nearby shore was the site of several small fishing villages that maintained a livelihood by fishing and cultivating the scanty soil. Hong Kong's greatest asset—in fact, its only natural asset—was its magnificent, almost landlocked harbor, which served as a haven from the dreaded tai-phoos ("big wind"—the origin of the English word typhoon) of the South China Sea. For many years, it was used almost exclusively by pirates. (The name Hong Kong, in Cantonese, means "fragrant harbor.") Thus, for nearly 2,000 years, the only substantial form of wealth in Hong Kong was that stolen and brought there by pirates.

The British in Hong Kong

When the British discovered Hong Kong in the 1800s—her merchant-explorers seeking to obtain Chinese tea—they immediately recognized its value and set up trading posts there to be near Canton. Unfortunately, friction soon developed between the British and Chinese, resulting in the Opium War of 1839–42. Negotiations to prevent the war were hindered by the fact that all Europeans were considered barbarians by Chinese officials, with whom direct communication was forbidden, and by the continued smuggling of opium into China by British merchants. As a result of the Treaty of Nanking, which ended the fighting, Britain received Hong Kong Island "in perpetuity" so that her merchants might have "a port whereat they may careen and refit their ships."[1] (A subsequent treaty in 1860 gave Kowloon Peninsula to Britain while in 1898 China leased the New Territories to Britain for 99 years.)

News of the end of "hostilities" (war was never declared) was greeted with much satisfaction in England, where the ideas of free trade and nonintervention were gaining popularity. There was less rejoicing, however, at the news that the British negotiator, Sir Henry Pottinger, had exceeded his instructions and obtained Hong Kong. (The British government said it would have been satisfied with a treaty guaranteeing the security of its merchants.) Ironically, the ascendancy of the disciples of Adam Smith in England made the government hesitant to assume any more colonial responsibilities.

Yet it was precisely because free-trade ideas were on the rise that Hong Kong, from the very beginning, was set on its course as a model of free enterprise: Hong Kong would be accepted into the Empire not as a "Gibraltar of the East," as some military strategists wanted, but as an emporium of trade between East and West—a free port. The free-traders viewed the British Empire not as a military empire held together by the force of arms, but as a commercial empire held together by millions of mutually beneficial relationships. These were the kinds of libertarian attitudes that helped make the period from 1815 to 1914 one of the most peaceful centuries in the history of the world.

In the early years, Hong Kong was viewed as little more than an arid rock. Lord Palmerston, the foreign minister, called it "a barren rock with nary a house upon it," while Prince Albert is supposed to have laughed when he heard that the mighty British Empire had obtained little Hong Kong. And when provoked to strong language, fashionable London ladies cried, "Go to Hong Kong!"[2]

In defense of his actions, Pottinger wrote: ". . . the retention of Hong Kong is the only single point in which I intentionally exceeded my modified instructions, but every single hour I have passed in this superb country [China] has convinced me of the necessity and desirability of our possessing such a settlement as an emporium for our trade and a place from which Her Majesty's subjects in China may be alike protected and controlled."[3]

Hong Kong probably would have remained undeveloped, and Sir Henry would have been discredited, had it not been for its status as a free port, where virtually no duties or tariffs would be collected. Not having tariffs would provide several key advantages that would guarantee prosperity.

First, inefficient industries would be quickly eliminated, since Hong Kong entrepreneurs would be able to respond to the true vicissitudes of the market; no buggy whip factory would outlive its usefulness shielded by a "protective" tariff.

Second, the market would direct the people of Hong Kong to do what they do best. For exam-

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ple, although Hong Kong has one of the world's best harbors, it has little farmland. No matter how high Hong Kong might place tariffs on foodstuffs to "protect" and encourage its own farms, it would never be able to become self-sufficient in agriculture (even though today its capitalist farmers harvest eight crops per year). Instead, Hong Kong would do better importing food—at the lowest cost possible—and servicing ships in its excellent harbor to pay for it. This is indeed what happened.

Third, free trade would allow the people of Hong Kong to buy commodities and raw materials as cheaply as possible. The money saved by not paying a tariff, duty, or tax could be used to buy additional products and materials and thus realize a higher standard of living than otherwise would be possible. Instead of sending the fruits of their labor to Great Britain in the form of customs duties, Hong Kong consumers and businessmen would be able to spend and invest this "saved" money as they saw fit. French economist Frederic Bastiat went so far as to refer to such "savings" as a gift: "When a product—coal, iron, wheat, or textiles—comes to us from abroad, and when we can acquire it for less labor than if we produced it ourselves, the difference is a gratuitous gift that is conferred upon us."[4] Hong Kong, with few natural resources, would depend on tariff-free "gifts" for its livelihood.

Finally, since resources could be obtained more cheaply, production could be enhanced, thus satisfying consumers, further improving quality and lowering costs, and creating more jobs.

An Oasis of Freedom

From the very outset, the British sought to remain true to their intention of setting up Hong Kong as an oasis of freedom—and not just for businessmen. Captain Charles Eliot, the military governor of Hong Kong, issued a proclamation that guaranteed protection for all the people and assured them that they were "further secured in the free exercise of their religious rights, ceremonies, and social customs. . . ."[5] The colony was charged with operating a limited and frugal government: the principle was stated that the British government "expects that the local revenue will be adequate to defray . . . all the . . . expenses of the government of Hong Kong," and that there should be "a strict observance of an enlightened frugality in every branch . . . of the local government."

Having no tariff income, Hong Kong's government was financed by the sale or lease of land. As far as the opium trade was concerned, the British government set forth the following policy: "The British opium smuggler must receive no protection or support, and all officials must hold aloof from so discreditable a traffic." The first ordinance passed in Hong Kong forbade all forms of slavery. This made conditions in Hong Kong consistent with the rest of the Empire, which had abolished slavery throughout its realms in the early 1800s.

Soon Victorian voluntarism began to meet the needs of the people of Hong Kong. Churches and places of worship were among the first buildings to be constructed. The London Missionary Society, under the leadership of Dr. James Legge, built the Union Chapel in 1845. American Protestant missionaries were particularly active. The first church was built by the American Baptists, followed soon after by the Catholic Church of the Immaculate Conception. The Moslems erected a mosque, while the Chinese began building their own temples. In 1849, the Anglican Church was completed, and an Anglican bishopric was established completely through private endowment. Societies of all kinds were set up. A Chinese branch of the Royal Asiatic Society, an amateur dramatic club, St. Paul's College, the Hong Kong Chamber of Commerce, and private schools for both Chinese and British were created by voluntary effort.

Although Hong Kong was a place for individualism, the flip side of individualism is not a wanton disregard for the needs of others, but the principle of voluntarism. Such voluntary and philanthropic efforts were consistent with the policies of English free-traders, who thought that each colony should be able to fend for itself and create its own services.

Those who decry Western values—including the classical liberal political and economic tradition that developed in the West—should take note of the British treatment of the thousands of Chinese who flocked to live under the British flag. Tossed to and fro by the whims of despotic mandarins, quarreling war lords, and the corrupt

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Manchu Dynasty, the Chinese found both opportunity and near equality with the British in Hong Kong. The appointment of Chinese to responsible positions was agreed to as early as 1855. In 1857, Chinese were allowed to qualify as lawyers. In 1858, Chinese were permitted to serve as jurymen, allowed to register their ships under the British flag (if they held land in Hong Kong), and wills drawn up in accordance with Chinese usage were considered valid in court. The British also extended equal treatment to the boat people, or Tanka. For centuries, Chinese law forbade them to settle ashore, marry landowners, or take government examinations. Such discrimination ended under British rule and the Chinese population grew from 20,338 in 1848 to 121,825 in 1865.

Despite all the advantages the British gave to the Chinese, it was no one-way street. In 1894, Lord Ripon wrote to Governor Sir William Robinson: ". . . under the protection of the British Government, Hong Kong has become a Chinese rather than a British community . . . and Chinese settlement . . . has been one main element in its prosperity."[6]

Throughout the 19th century, Hong Kong's business pursuits were centered around shipping and trade. In 1881, over 3,200 ships entered Hong Kong. That same year over 24,000 Chinese junks also passed through the harbor. To service these ships, there were 400 ship chandler shops, 20 rope factories, 93 boat works, two cannon foundries, and one dry dock. To handle all the transactions that went along with these services, many banks were founded or established in Hong Kong, including the Oriental Bank; the Mercantile Bank of India, Australia, and China; the Hong Kong and Shanghai Bank; and the United Service Bank.[7]

Into the 20th Century

In the 20th century, a new phase of Hong Kong history began: over the next 80 years Hong Kong would become a refuge for millions of Chinese fleeing persecution, instability, and violence, a home to millions of people, an industrial dynamo, as well as the site of a great airport built on land reclaimed from the sea.

The influx of refugees came in six major waves in the 20th century. The first wave came in 1911, as a result of the revolutions that overthrew the Manchu Dynasty and established the Republic of China. The second wave came in 1937, after Japan invaded China. During World War II, Hong Kong was captured by Japan. Cut off from world markets, the island languished. More than one million Chinese left Hong Kong and returned to mainland China. Since both were ruled by the heavy hand of Japanese militarism, there was little advantage to staying in Hong Kong. The third wave began in 1949 when the Communists took over China.

A fourth wave of immigration occurred in 1962, when widespread starvation—the result of Communist China's socialist land-use policies—forced thousands of Chinese to emigrate. In one 25-day period in 1962, Communist Chinese border guards allowed 70,000 Chinese to walk to freedom in Hong Kong. The Cultural Revolution in the late 1960s sent another human wave into Hong Kong, while the 1970s saw over 100,000 Vietnamese boat people find refuge there. Fourteen thousand were given permanent resident status, while 100,000 were permitted to work in Hong Kong pending transfer to permanent homes abroad.[8]

In the years after World War II, Hong Kong took advantage of the human capital from Communist China, and began producing goods that appeared in markets all over the world. With few raw materials, no local sources of power such as coal and oil, and shortages of land and water, Hong Kong developed one of the fastest growing economies in the world.

From 1,050 separate industries, employing 64,000 people in 1947, the figure rose to 17,239 industries employing 589,505 in 1970. Most of the factories were still family concerns, using their own "capital"—including family members' hard work—to produce quality goods at low prices. By 1970 the textile industry employed 30 percent of the work force and produced 40 percent of total exports. Plastics accounted for 12 percent of exports; electronics, 10 percent. Highly developed countries, such as Great Britain and America, began "protecting" themselves by asking Hong Kong to impose "voluntary" quotas on many of its exports. By this time, Hong Kong's trade volume had passed that of much larger countries, such as New Zealand.[9]

In the early 1980s, realizing that socialism had failed to produce a healthy economy, the People's

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HONG KONG ECONOMIC AND TRADE OFFICE

Hong Kong's Central District.

Republic of China established four Special Economic Zones where its people could learn the world's economic ways. All the zones were set up in southeast China, and for good reason: to be near Hong Kong. Since that time, investment capital, visitors, and Hong Kong know-how have crossed the border to quicken the pace of Chinese economic development. Shenzhen, the largest and most successful of the economic zones, is located directly across the border. In 1983, of some 1,600 government-approved contracts, about 50 percent were with Hong Kong firms. Short of space, Hong Kong entrepreneurs were using land in China for everything from country clubs to cemeteries.[10]

Today, little Hong Kong—which fuels its own vibrant economy as well as much of China's—has more than 150 banks, four stock exchanges, and is the world's third largest financial center. It is the third largest diamond and gold trading center, the largest manufacturer of toys, and the second largest maker of watches. It has an infant mortality rate lower than that of either Britain or the United States, and one of the highest protein-consumption rates in the world. In the early 1980s, during a worldwide recession, Hong Kong had a maximum 5.2 percent unemployment rate when Britain's was more than twice as high. Over 2 million tourists visit annually, to shop in this oasis of freedom where East meets West. Chinese author Han Su Yin described Hong Kong as "the deep roaring bustling eternal market . . . where life and love and souls and blood and all things made and grown under the sun are bought and sold and smuggled and squandered."[11] Fueled by free trade, Hong Kong's growth rate from 1975 to 1987 was 11.8 percent, while Communist China's was only 4.3 percent.

A recent Fodor's tourist guide book to Hong Kong and Macau has this to say about "Doing Business": "Hong Kong is one of those rare places on earth that plays the free-trade game according to the classical rule. . . . A national of any country may do business or set up business (so long as it is legal). . . . The rules of business in Hong Kong are few. Whether you are a visiting businessperson or a potential entrepreneur, you will not go far wrong if you remember this:

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You are in a 'free country.' If you succeed, you can take all the credit; if you fail, you must take all the blame. The authorities give some help (but no subsidies, tax reliefs, or featherbeds); what is more important, they don't hinder you. . . . There is no capital gains tax . . . income arisen from abroad goes tax free. . . . The Hong Kong salaries tax return is one simple sheet. . . . There is no income tax withholding. . . . The government's intervention in business affairs in minimal."[12] Milton Friedman has called Hong Kong "the modern exemplar of free markets and limited government."[13]

No Utopia

Hong Kong is no utopia: never has been, never will be. A nexus between East and West, it has always been a center of opium trade—first legal, now illegal. It is one of the most crowded places on earth, and hence, there is little tolerance for new refugees. There are great disparities between rich and poor. Yet there appears to be little discontent about the division of wealth because of the opportunity for advancement. Yesterday's shanty dweller lives in a resettlement block today, tomorrow—if he works hard—he may live in upscale Repulse Bay.

Unfortunately, Hong Kong's days are numbered. In 1984, Britain signed a Joint Declaration with Communist China, turning over sovereignty of the New Territories (over 90 percent of the colony) to China in 1997. China guaranteed that the capitalist system would last for at least 50 years and that democratic institutions would be preserved. Their slogan for the union: "one country, two systems."

Hong Kong has not reacted well to the negotiations or the settlement. From 1981 to 1983, stock-market prices fell 50 percent. The budget for 1983-84 incurred a deficit, something unheard of in Hong Kong, which believes in surpluses. Billions of dollars flowed out of Hong Kong, so much that neighbors like the Philippines, Thailand, and Malaysia set up programs to attract its panic money.

Hong Kongians had hoped that Britain would give them British citizenship or the "right of abode" on British soil if they had to flee the Communists. So far, the British haven't acted. Unlike people in "dependencies" belonging to other countries, those in British dependencies don't automatically have British citizenship. As a result, even before the massacres in Tiananmen Square, a mass exodus began. In 1986, 19,000 residents left; in 1987, 30,000; in 1988, 45,000.

The exodus is carrying away some of the city's most productive citizens—professionals and middle managers. Seventy-five percent of all pharmacists are planning to emigrate before China takes over in 1997; shortages among police, fire, and judicial officers are already growing serious. After 1984, many people began leaving Hong Kong for a time to live in countries like Canada, the U.S., and Australia in order to qualify for a foreign passport. Then they can return to Hong Kong safe in the knowledge that if things go bad, they have a refuge.[14]

The massacre in Tiananmen Square and the deception that followed have only confirmed Hong Kong's fears. Polls taken immediately after the Beijing massacre indicate that most Hong Kongians don't want to leave—Hong Kong is their home. Yet to stay would place them under the same coercive government from which they and their parents fled. "The majority of people in Hong Kong feel helpless," says Jonathan Chao, director of the Chinese Church Research Center there. One prominent lawyer went so far as to say, on Hong Kong television, that "For England to give 5.5 million people to Communist China is like giving 6 million Jews to the Nazis." As this is being written, delegations from Hong Kong are appealing to Great Britain for the right to emigrate and live there.[15]

Supporting the idea that all Hong Kongians should be given British citizenship, Frank Ching, writing in *The Wall Street Journal*, explains:

"No other democracy denies a dependent people the right to self-determination or forces them to live under a Communist government.

"No other democracy issues passports that do not entitle their holders to enter the country that issued the passports.

"When British Gibraltar and the Falklands were threatened with takeover by another country, Britain offered the people protection by giving them full-citizenship rights.

"Hong Kong is the only exception. The British are now preparing to hand over its 5.5 million people to a Communist government. The decent thing for Britain to do is to restore the citizenship

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rights of the people in Hong Kong. It is the only way remaining to salvage Hong Kong and restore British honor."[16]

As Ching points out, even if the British acknowledge that the land was on a lease, the people are not. As such, they should be given full citizenship rights—much as the U.S. has extended rights to Puerto Ricans, and Holland has given full rights to her dependents in the Netherlands Antilles and Aruba. British citizenship would be something the Communist Chinese couldn't take away, if and when they dismantle Hong Kong's free market system. It might even insure that China wouldn't tamper with Hong Kong's market.

In the light of Tiananmen Square, the British should use every means to renegotiate the joint accords, telling the Chinese that what happened this summer was not acceptable. The Tiananmen Square massacre—set against the backdrop of China's historic political instability and isolationism—makes it inconceivable that Communist China would allow Hong Kong to continue its Western contacts—including Western newspapers with their stock market reports, its aviation and shipping treaties, its checkbook accounts (which are not permitted in Communist China) and myriads of other capitalistic institutions.

China's Communist regime is trapped in a catch-22 situation: the only thing that can save its economy—a free market such as exists in Hong Kong—is the very thing that will reduce the regime's totalitarian powers by giving power to entrepreneurs and consumers. So far, whenever Communist leaders have had to choose between a better economy or keeping power concentrated in their hands, they have always chosen the latter. To allow Hong Kong to continue "business as usual" after 1997 would guarantee a heavy flow of ideas on liberty, and that, as the world saw last summer, the present Chinese government cannot tolerate. It was apparently Deng Xiaoping who ordered the army to fire on the students, the same man who signed the Hong Kong accord with Margaret Thatcher.

Ironically, Communist China would be the chief beneficiary of continued British sovereignty over Hong Kong. Hong Kong accounts for at least 35 percent of China's annual foreign exchange earnings. China also benefits from Hong Kong's financial services, port facilities, and skills in marketing Chinese products. All this will most likely change when Hong Kong passes into Chinese hands. China threatens to kill the goose that lays the golden egg.

Britain needs to act quickly. To lose Hong Kong as an outpost of freedom in 1997, with its 5.5 million people, would be tragic indeed. □

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4. George Charles Roche III, *Frederic Bastiat: A Man Alone* (New Rochelle, N.Y.: Arlington House, 1971), p. 53.
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8. *Fodor's Hong Kong and Macau* (New York: Fodor's Travel Guides, 1987), p. 25.
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13. Milton and Rose Friedman, *Free to Choose* (New York: Harcourt Brace Jovanovich, 1979, 1980), p. 34.
14. Frank Ching, "Hong Kong's Hopes Wane as Britannia Waives the Rules," *Wall Street Journal*, April 19, 1989, p. A19.
15. These impressions were gained from telephone interviews with an American student in Hong Kong through the month of June, 1989; Jonathan Chao, quoted in *World*, July 1, 1989, p. 7.
16. Ching, p. A19.

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What We Should Teach the Eastern Europeans

by Tibor R. Machan

President Bush went to Poland and Hungary last summer, and those who care about the resurgence of freedom in Eastern European countries should be concerned about the significance of these visits. As a Hungarian refugee, and also as someone very interested in political affairs, it concerns me that the Bush visit may begin a period of international blunders. Will Mr. Bush make clear to the leaders in these countries what is most important to their future both on the economic and political fronts—indeed, as viable, flourishing cultures?

The most important lesson the Polish and Hungarians can learn at this time is that they must build opportunities for self-help. This means, among other things, that economically the worst thing for these societies would be to learn to depend on foreign aid from the United States and other governments. It would be best for them to create a truly hospitable business climate.

Yet the problem goes beyond economics, all the way to the kind of culture these societies might develop after years of having to dance to the Kremlin's tune. One thing they do not need is further dependence on the decisions of the politicians of other nations—in either the Soviet Union or the United States. And getting involved in a massive aid program—whereby instead of making the business climate suitable for foreign investment, it is to foreign government help that they will look—is entirely ill-suited to becoming an independent society, a culture with its own identity and political independence.

The lesson of the value of political independence could be taught no better than by leaders of the freest society in the world, the United States. The very birth of the U.S. testifies to the importance of establishing political independence by means of economic self-sufficiency. Some Poles and Hungarians might believe that the way out from under the yoke of the Soviet Union is to cuddle up closely to the several major Western governments, but they are mistaken. Indeed some Hungarians are fully aware of this. Let us consider for a moment the Polish and Hungarian situations.

Both Poland and Hungary are supposed to be proof that the Soviet bloc is no longer true to its Stalinist ways. There are reports of thawing in the Soviet orbit. This has led to the view that there is a real chance for socialism with a human face, with its Stalinist, tyrannical elements fully shorn. A visit to Poland and Hungary confirms this impression. The thaw itself, of course, has much to do with such economic facts as Hungary's benefit from Western trade and tourism.

Personal Testimony

There are other reports as well. Let us start with the most personal testimony I can think of, from my own mother, who now lives in Germany, coaches fencers in Austria, and has hardly a moment to herself because of the demands of her busy schedule. Yet she would never trade the hustle and bustle of her Western life for what she regards as the still basically phony atmospherics of contemporary Budapest. (She was allowed to

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leave at retirement age: socialism has no use for retired citizens.) By her account, "Up until recently it has been mostly surface stuff; the regime may still be able to resume its old style." The full import of that remark may be better appreciated when expressed in the words of a Hungarian scholar who has had the rare privilege of travel in the West. In the early 1980s he spoke to me as follows:

> No, you no longer find the kind of brutality in Hungary we experienced in the Stalinist era of Rakosi and immediately following the 1956 revolution. But why? Partly because it is no longer necessary—people have accepted the system and have come to learn how to live around it. The people no longer believe it can be gotten rid of by forcible retaliation against the regime and its Soviet backers. They no longer believe anyone from the West is going to help them—they certainly do not, as they used to, count on America for such help, even though they still wish for it. But should there be a revival of the hard-line attitude in the population, there is no good reason at all to think that the brutal approach would not be tried again.

This scholar, who shall remain nameless for obvious reasons, also mentioned in a letter to me that there recently have been more basic obstacles to the re-emergence of Stalinist Marxism in Hungary. They have to do in part with what has been going on since the 1956 revolution.

> The plain fact is that there are no Marxists, in the sense the Soviets use that term, left in Hungary—or, for that matter, in most of the Eastern bloc nations. I would add that there are more Marxists, even of the soft type, in the West than in the Eastern bloc! The doctrine has been given up not just because of the use to which it was put. After all, there are many who are Marxists and considered Stalin an abomination. But the system does not work in a more profound sense: one cannot govern a society in terms of it. We cannot look at people as simply tools to prepare for a revolutionary future. Planning a society is literally impossible, and we now know this. Marx, Lenin, Stalin, and the rest did not know this, nor did their ideological supporters. Among Hungarian intellectuals no one believes in the possibility of a genuine socialist society, unless one distorts this term to mean something highly decentralized on the order of a kibbutz or convent. To allocate resources, to generate creative energy, to prepare for future needs, wants, and contingencies of actual people—rather than the homogeneous ant colony fantasized in orthodox Marxism/Leninism—one requires a free marketplace, period. We know this, the Poles know it, and I know some of the Russians are coming to realize it too.

Some Complex Realities

By now it clearly appears that many of Hungary's leading intellectuals have changed philosophically. The prevailing economic philosophy is anything but socialist, even though for political reasons there are not yet major institutional changes that reflect this transformation. It is these changes in outlook and new ideas, in the midst of the intractable and devastating results of socialist mismanagement of the country—not merely the equally necessary thawing of Soviet socialism—that account for the "liberalization" we perceive in Hungary. But there must be more to the current transformation than the motivation to do something new, to abandon an experiment that never should have been tried in the first place.

Economics is just one aspect of life, and change in economic understanding will not suffice to produce lasting constitutional and institutional changes. In these other areas, where realities are more complex and hidden and do not stare you in the face as economic realities often do, there is an actual revolution—a basic change—under way in Hungary.

Again, there is not much that can be reported—indeed, when some years ago I offered to do a major story on these developments for a national magazine, my sources begged me to desist: "You will give away the ball game!" Suffice it to say that during the last decade, in the various corners of culture that are touched by the work of intellectuals of all disciplines and specialization, Hungarian statism and censorship have been gradually undermined. Slowly, but deliberately, the Hungarian intellectual community has been

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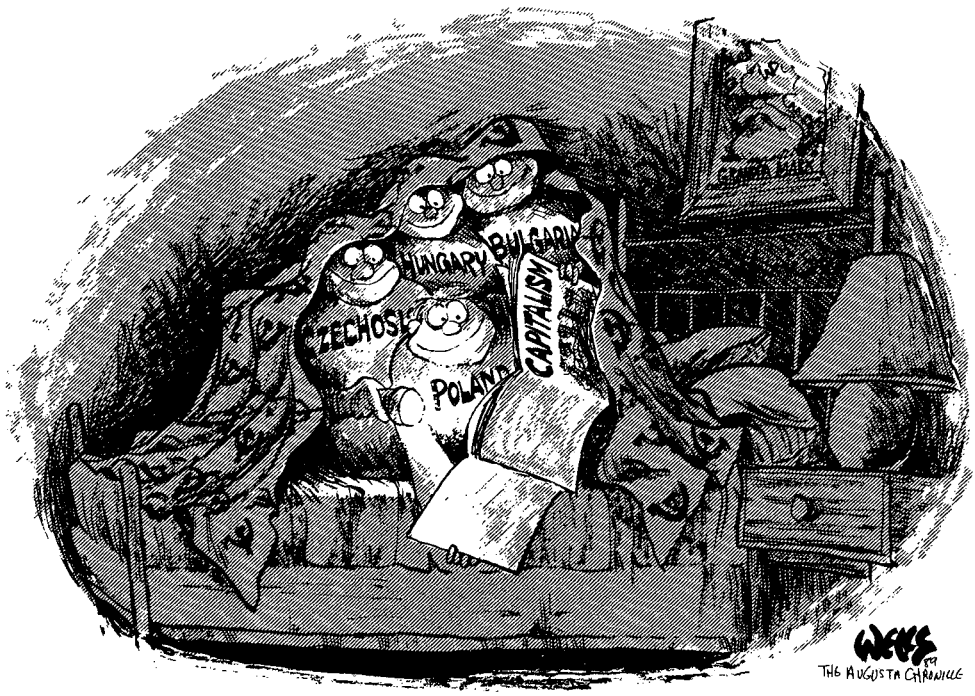

laying the foundation for a new culture. The reading materials, the works of art, and the dramatic offerings in Hungarian culture are once again recovering their earlier, pre-Nazi, post-Hapsburgian cosmopolitan and liberal flavor. The intellectual community has been making excellent use of the "thawing," which is partly the result of heeding the lesson Milton Friedman has been teaching us for decades: with economic freedom you are bound to gain more political freedom. (Dr. Friedman's books recently have been translated into Hungarian, and both Polish and Hungarian economists are openly turning to his free market theories to get help in their efforts to rejuvenate their economies.)

There is a lesson for us in this, and Western diplomatic and economic experts dealing with Eastern European affairs might pay heed to it: A society is in need of a vision of itself; the people need an integrating, broad political idea as to the basic principles the system should exhibit.

What is very scary is that Western liberal democracies are losing sight of this vision. We are now in a situation where those few prominent people who are espousing the vision of a free society are all economists. But their specialized discipline cannot be fully entrusted with the task of spelling out and creating the motivation to uphold the system. The economist is not in the business of setting priorities for us, but in the business of explaining what the consequences of various institutional policies are for our overall material well-being.

Western diplomats and foreign policy strategists should not, therefore, rely only on the advice of economic policy experts, but draw lessons from thinkers such as the American Founding Fathers and Abraham Lincoln. These individuals knew that America's pre-eminence in the world did not depend merely on capitalism, but was the function of a deeper philosophical ideal, namely, that of individual sovereignty. That idea helped undo America's worst institution, slavery. It may, if its leaders keep it in mind, undo the enslavement of people throughout the world.

And from a practical standpoint that is just what places like Poland and Hungary need: a fundamental commitment to individual liberty and, *therefore*, a self-regulating marketplace. So, by insisting on the basic ideals of freedom, Western diplomats in touch with the new leadership in Poland and Hungary will help to pave the way for the best possible kind of business recovery in the Eastern European countries—a recovery founded not on temporary public policy but on basic reform of the institutions of society. □

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Communal Politics in India

by Rayasam V. Prasad

"The communal card always played a key role in our electioneering, but has never enjoyed the blatant currency it is beginning to now. The tragedy is that it is not the ruling party alone that is to blame. For decades, political parties of all hues have pandered to communal forces."

Recently, a reporter—while discussing the brutal killings and property damage caused by communal riots in India—wondered about the powerful influence of caste and religion on India's public life. He recommended that a sociological study be undertaken on the subject.

During the euphoria of India's struggle for independence, many predicted that this anachronistic division of society would disappear with the spread of literacy. But the communal virus continues to affect all—poor and rich, literate or otherwise. In a recent speech, Prime Minister Rajiv Gandhi said that the people are still dividing themselves on the bases of religion, caste, and sub-caste, and that this is perhaps the most dangerous trend in the country today.

It is common to talk about how each caste is represented in the state and central cabinets. For example, one Indian commentator recently stated: "Choosing a high caste man [as a chief minister] would have been tantamount to setting the clock back in a state where the alignment of social classes and castes had definitely been in favor of the backward castes." Politicians and newspapers routinely engage in such calculations.

In the name of socialism, the government concentrates power in its own hands, controls access to production, and engages in arbitrary distribution of goods and services. In such an atmosphere, to belong to a group with influence over politicians and bureaucrats means survival, progress, and prosperity. The caste system serves as an old solution to these new problems.

In day-to-day life, communal influences are very strong. If you are a government official, for example, your superior, who may belong to another caste or religion, can downgrade your evaluation and thus your chances for promotion. You can be transferred to places you never knew existed. People belonging to a powerful caste can obtain jobs, promotions, and exclusive permits and licenses. It is cheaper than to pay the huge bribes.

People belonging to other castes and religions feel threatened, huddle together, and wait for their chance at the wheel. Leaders of these groups negotiate with politicians for a slice of the power in return for votes. "We have decided to create a strong vote bank on our demands. Only those who support these will get our votes," says a religious leader.

Even the judicial and police appointments aren't immune from communal considerations. With enough support from politicians, one can engage in criminal behavior with no fear of reprisal or punishment. With the backing of these criminals, politicians intimidate their opponents on a regular basis. Thus, one cannot dream of entering public life without the constant support of an army of hooligans.

"I cannot trust police any more in this town," says a victim of recent communal clashes. People, out of desperation, take the law into their own

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hands, and communal riots are as predictable as monsoon rains.

This artificial division of society does trouble some Indians. The judge who recently ruled in favor of "Tamas"—a television show attacking fundamentalists in both the Hindu and Muslim communities—said, "the message is loud and clear, directed as it is against the sickness of communalism . . . the extremists stand opposed . . . when realization dawns on both communities who ultimately unite as brothers." Both Hindu and Muslim extremists opposed the screening of this program.

For most people in socialist India, however, the lure of communalism is too powerful to resist. By belonging to a ruling caste, you get a promotion and your son gains admission to a good college. Soon, belonging to a particular religion or caste becomes an integral part of your self-image. You learn to distrust "others" as a part of this learned behavior that benefits you.

Politicians know that if they ignore these powerful forces, they are doomed. They go with the flow, and gain maximum advantage from caste and religious differences. The power they accumulate—all in the name of socialism—helps them cater to various factions. The caste system thrives in this atmosphere of political patronage.

There is another reason why people distrust "others" and seek comfort among their caste members. The explanation can be found in Hernando de Soto's magnificent book, *The Other Path*, in which he describes the various networks of "cousins" and "uncles" operating in Peru's underground economy.

People in free market economies slowly learn to trust strangers. The reason is simple. You and your business partner have an enforceable contract. The same goes for consumer and provider, landlord and tenant, stockholder and company, employer and employee, and so on. Respect for private property and enforceable contracts enable millions of strangers to deal with each other in complex, large-scale production and distribution processes.

In India, as in Peru, high tax rates and overwhelming governmental regulation have driven a large part of the economy into the informal sector. Even the legal businesses have two sets of books.

People operating in such an illegal underground economy don't have the luxury of enforceable contracts. They have to depend upon people they know and can relate to. In India, the caste system serves as a convenient vehicle for that kind of kinship.

Communal politics in India is a new phenomenon spawned by socialism. Deregulation, reduced tax rates, and transfer of productive processes back to the people will melt away the foundations of the underground economy. All this coupled with decentralization will destroy the forces behind communalism, corruption, violence, and disorder. □

IDEAS ON LIBERTY

The Despotism of Faction

The despotism of faction is not less to be dreaded than the despotism of an individual. When the bulk of the community are engrossed by private concerns, the smallest parties need not despair of getting the upper hand in public affairs. At such times it is not rare to see on the great stage of the world, as we see in our theaters, a multitude represented by a few players, who alone speak in the name of an absent or inattentive crowd: they alone are in action, while all others are stationary; they regulate everything by their own caprice; they change the laws and tyrannize at will over the manners of the country; and then men wonder to see into how small a number of weak and worthless hands a great people may fall.

—ALEXIS DE TOCQUEVILLE

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A Room with a New View

by Steve Lopez

Three years ago, architect Peter Fox is fresh out of college and catches a bus for his first day on the job. The bus pulls up to 20th and Chestnut, the door opens, and there's some guy camped out on the sidewalk like he owns the property.

Next day, same thing. And the next day, and the next.

"I had to step over him every morning," Fox says.

Fox would continue on to work, where he sat against a window one flight above 20th Street. Sometimes he'd design a new swimming pool for someone who was unhappy with their old swimming pool. And when his work didn't seem to reflect reality, there was always the window.

Three years later, the man is still out there; Peter Fox is still looking.

They don't know each other. But Fox has found comfort and inspiration in just looking. And the man—oblivious to his starring role in the drama Fox sees through his window—is comfortable with his own invisibility.

The man outside says he is John Madison, Vietnam veteran.

"Shortly after I started," Fox wrote in a letter, "a Korean fruit stand opened. At first the street guy would bum them for food and money."

Agents of Change

It looked like only a matter of time before one of them drove out the other. But that didn't happen.

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"Pretty soon they had him helping unload their truck in the morning when it arrived from the food distribution center."

This despite a language barrier. On some level, maybe because both Madison and the Koreans were on the edge of things, they made a connection.

"Next he was sweeping the sidewalk, then driving the truck for them, all the time his appearance improving."

Partly because he was getting paid by the Korean fruit vendors. A couple bucks here, a couple bucks there. What was emerging, gradually, was the new John Madison.

"Better clothes, haircut, apparently now off the street. And the wild look disappearing from his eyes."

What Fox didn't know—nobody knew—was that Madison had taken to camping in a quiet alcove near the Boy Scouts of America office several blocks away. Though it was still the street, to him it was a fancier address, fit for a man of his upward mobility.

New Responsibilities

"As the fortunes of the vendors improved, they, along with their relatives, bought several shops on the block, and the street guy became responsible for maintaining all of the shops, as well as the street and sidewalk along the entire block."

Fox watched as the John Madison Corporation conquered new territory. With a household broom, he had staked out the west side of 20th Street from Market to Chestnut. He had the side-

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walk so clean you had to look twice to figure out what was wrong with the picture. He even dug cigarette butts out of cracks.

And he was diversifying.

"He is now holding down two jobs—collecting trash for a private hauler in the early morning and then arriving (usually hanging off the side of the trash truck) to work for the Koreans and other merchants."

Madison's abilities did not escape the notice of the management of Nuts to You, one of the few remaining non-Korean businesses on the block. Manny Radbill, the owner, occasionally had Madison clean his van. One time Madison found money in it and immediately gave it to Radbill. Debbie Alexander, Radbill's manager, remembers the time she handed Madison a Christmas bonus. He refused.

Much out of Little

To John Madison, words and possessions are confusing fragments of a complicated world. His luxury is to need so little.

His only vice, Radbill says, is a beer or two on a warm afternoon, a habit the Koreans do not seem to appreciate. Most of them, however, see in Madison a little bit of themselves. He works hard, says Hyun Jin. What else is there?

There is Peter Fox, watching the whole thing out the window. And there's Madison, the man he used to step over.

"It has been very inspiring to watch all of this happen. It's a great reflection of the Korean merchants, refugees themselves, who in establishing themselves and their families in this country have found room in their plan to reach down to someone more displaced than themselves and pull him up with them."

Madison says he's off the streets now and rents space in a North Philadelphia house for $3.00 a night. He liked hearing that people have seen the change in him and appreciate what he's done for the block.

As Madison smiled at the thought, broom in hand, Peter Fox watched through the window. □

IDEAS ON LIBERTY

Self-Reliance

I yield to no man in the world in a hearty goodwill towards the great body of the working classes, but my sympathy is not of that morbid kind which would lead me to despond over their future prospects. Nor do I partake of that spurious humanity which would indulge in an unreasoning kind of philanthropy at the expense of the great bulk of the community. Mine is that masculine species of charity which would lead me to inculcate in the minds of the labouring classes the love of independence, the privilege of self-respect, the disdain of being patronised or petted, the desire to accumulate, and the ambition to rise. I know it has been found easier to please the people by holding out flattering and delusive prospects of cheap benefits . . . rather than by urging them to a course of self-reliance, but while I will not be a sycophant of the great, I cannot become the parasite of the poor.

—Richard Cobden

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The Coming Push for National Health Care

by Terree P. Wasley

Conservatives and free-marketeers across the country have cause to celebrate these days. For the first time in decades, Congress has eliminated a welfare-state program. Repealing the catastrophic care plan for the elderly has raised hopes that future spending sprees on health care will face insurmountable opposition in Congress. Health care experts, journalists, and broadcast commentators have advised that other forays by the government into health issues, such as mandated benefits, long-term or nursing home care, national health insurance, and nationalized health care are virtually dead in the water. *The Wall Street Journal* even remarked that this recent defeat has killed for now any further attempts to socialize American medicine.

Despite this remarkable success in rolling back one program, now is *not* the time for those who believe in free markets to relax. If current wisdom is correct, then the Bush Administration has a unique window of opportunity through which to propose major reforms to this country's ailing health care system, bringing it back into balance with our free-market convictions. The time may be right to urge significant changes that would curtail spiraling health care costs, making health care more affordable and offering citizens the chance to choose the way to provide for their own future health care needs.

The Administration must act now, for to wait may allow an opportunity to pass that might never come again. Those who believe government can best provide for our lives are already working behind the scenes for passage of a comprehensive national health care plan for *all* Americans—and their target date is 1990.

Calls for some kind of national health care program have increased during the past year and are coming from a variety of sources. The rapid escalation in health care costs, particularly in the 1980s, and attention to the fact that approximately 30 million Americans lack health care insurance, have raised demands for some kind of universal solution.

Not too surprisingly, the A.F.L.-C.I.O. used its national convention in November to kick off a major campaign for national health insurance legislation in the next Congress. However, what has amazed some are voices from the business community speaking out for more federal government involvement in health care. Ever-rising health care costs, due to government interference and a perverse system of incentives and controls,[1] have so frustrated American business leaders that some have now resigned themselves to failure and are asking the government to bail them out.

Art Puccini, vice president at General Electric, in a speech early last year, said, "rising employee medical costs may lead some of us who today are free-market advocates to re-examine our thinking and positions with respect to government-sponsored national health insurance." Ford Motor Company has been using its seat on President Bush's competitiveness council to push for government health care, and General Motors vice president Beach Hall has been seen at several recent Capitol Hill meetings on the issue.

Terree P. Wasley is a Washington-based economist and free-lance writer who has worked on tax and health care issues for the U.S. Chamber of Commerce, the Goldwater Institute, and The Heritage Foundation.

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Walter B. Maher, director of employee benefits for Chrysler Corporation, has urged that a national budget be set for health care each year—much like in Canada, Britain, and other countries with national health care plans. The Washington Business Group on Health, which represents about 180 Fortune 500 companies on health issues, is one of several groups drafting a national health care plan with the goal of controlling health-related spending.

Astonishingly, it's not just big business, frustrated with mounting health care costs, that is turning a favorable eye toward a national health plan. A recent Dun & Bradstreet survey of *small* business found that 38 percent favored some form of national health insurance. The Independent Business Federation says 15 percent of its members polled in 1989 would agree to a mandatory national health insurance program.

In addition to business, another unlikely group has joined the clamor for national health care: physicians. Last year, Physicians for a National Health Program, a two-year-old group of 1,200 doctors from across the U.S., proposed a single public insurance plan that would pay for all approved medical services. According to Dr. Arnold Relman, editor-in-chief of the *New England Journal of Medicine*, "Nothing short of a comprehensive plan is likely to achieve the goals of universal access, cost containment and preservation of quality that everyone seems to want."

Many experts believe that it is currently impossible to undertake a national health care program of any kind, because of Federal budget deficits. Despite this, polls are showing that Americans see the deficit as less and less of a threat and that they are concerned about those who don't have access to health care because of its current high costs. Because of that concern, and if skyrocketing health costs are not slowed, some health care experts, such as Harvard University professor Robert J. Blendon, predict that national health care will become a major issue during the next few years.

Socialized medicine, the word normally used for a national care program, conjures up vivid images in most Americans' minds. One sees Soviet citizens dying because of a lack of adequate medical care, British citizens waiting for months to undergo a simple procedure or surgery, rich Europeans paying under the table to get their names pushed to the top of a waiting list, and Canadians hopping the border into the U.S. to have procedures done, rather than wait months or maybe years in their homeland.

No one, including most members of Congress, expects the American people to accept a socialized system like that of the Soviets, with its centralized control of every aspect of health care. Recent attention given to the severe problems besieging the British national health care system has prompted Prime Minister Thatcher to institute some market-based reforms and has turned proponents away from that example. However, many bills recently introduced in Congress would provide for a system of national health insurance modeled after the perceived success of the Canadian health care system.

One of the bills receiving the most attention is Senator Kennedy's "Minimum Health Benefits for All Workers Act." This bill would require all employers to provide health care insurance for workers and their dependents. Besides being a major intrusion by the government into individual and business decisions, the bill would increase health insurance costs by $100 billion, result in a loss of one million jobs, and spawn a further escalation in medical price inflation. One cannot overlook that mandated benefits are really transfer payments in disguise, with all the pernicious economic consequences of such transfers. A study by the National Center for Policy Analysis estimates that as many as 25 percent of the uninsured lack health coverage because current state-mandated benefit laws make it too expensive.

Governor Michael Dukakis has been touting his new Massachusetts universal health insurance program as a model for the nation, and politicians in some states have believed him. Under the Massachusetts program, all companies with more than five employees that don't provide insurance are required to contribute as much as $1,680 a year for each employee to a pool providing health insurance to people without coverage. Interestingly, a year after the plan has gone into effect, it is facing severe budget shortfalls, and hospitals and businesses are concerned they will be left footing the bill for skyrocketing costs.

Many politicians have praised the Canadian system of health care as successful in providing satisfactory health care at lower costs than the United States. But the problems inherent in any

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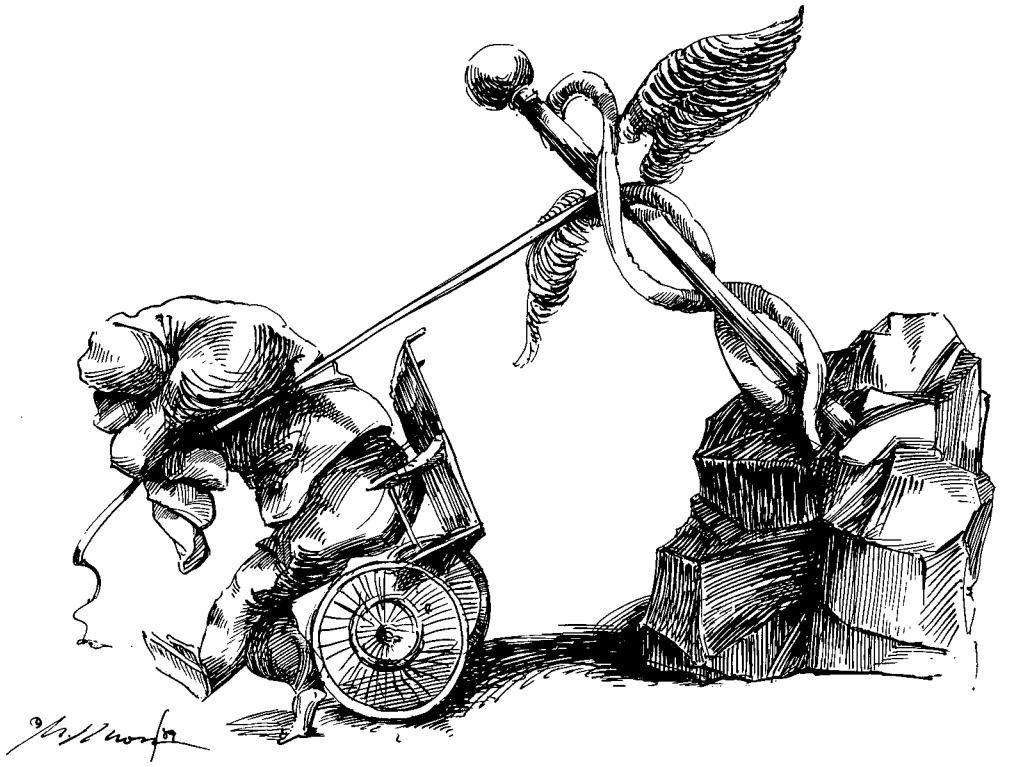

health system based on social insurance or direct government funding are already showing up in the Canadian program. These endemic flaws should give pause to U.S. lawmakers eager to adopt a plan similar to the Canadian one.

The underlying problem with any social insurance system is that patients make little or no contribution to the cost of their care. What follows is the exorbitant increase in the demand for health care services, and the resulting price controls, rationing, income controls on physicians, shortages of equipment, deterioration of medical facilities, and long waiting lists. Canada has exhibited all of these symptoms, and many Canadians routinely cross the border into the U.S. for treatment. Price controls, rationing, and waiting lists do put a lid on health care spending, and that is exactly why many politicians can boast that Canada spends less on health care than the United States. But is that the quality of health care Americans want?

As mentioned above, a unique window of opportunity may exist in Washington following the collapse of the catastrophic health care legislation. Now is the time to reverse the trend toward nationalizing our health care system and replace it with a free market. The creation of Medicare and Medicaid in the 1960s, their continued expansion, and the addition of a crazy quilt of health care programs by both the Federal and state governments have virtually destroyed Americans' access to reasonable and efficient health care.

Government intervention has our health care system caught in a vicious cycle of government-encouraged demand that drives up costs, bankrupts Federal and state budgets, and leads to still more infusions of money and program expansions that encourage additional consumption. Only the elimination of government interference and a return to a free market in health care will end the move toward nationalization. Only a free market will break the spiral of ever-increasing medical costs. As Ludwig von Mises wrote, "The pricing process of the unhampered market directs production into those channels in which it best serves the wishes of the consumers as manifested on the market."[2] Only a free market in health care will allow individuals maximum choice in meeting their health care needs. □

1. For a detailed history of our health care system, see *Critical Issues: A National Health System for America*, edited by Stuart M. Butler and Edmund F. Haislmaier (Washington, D.C.: The Heritage Foundation, 1989), chapter 1.

2. Ludwig von Mises, *Human Action: A Treatise on Economics* (Chicago: Contemporary Books, 1966), p. 394.

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Readers' Forum

To the Editors:

Robert James Bidinotto (*The Freeman*, September 1989) is too hasty in dismissing prison work programs. They don't reduce recidivism, and they can be used to mount prisoner escapes, he argues.

Faced with rising prison costs and problems with prisoner idleness, many states have looked to prison work as a solution. Fifteen American states have now initiated programs involving the employment of prison inmates by private companies. Prisoner employees are paid at the market rate (except where minimum wage laws intrude), and deductions are made to pay for prison accommodation, for victim compensation, and to pay taxes. What remains is put into a savings fund, available to the offender upon release.

These programs have not emerged as the result of lobbying by what Bidinotto calls the "Excuse-Making Industry." They usually have as much support from conservatives as from the left, because they reduce prison costs at the same time as aiming at something more constructive than incarceration. The programs are also ethically sound, because they help to make amends to the victim. Without work, offenders languish in prison at the expense of their victims.

There is evidence to show that the programs reduce recidivism. In California, prisoners are employed by TWA as flight reservation agents. The scheme has been in operation for only three years, but early evidence shows substantially lower rates of re-conviction for those who have passed through the program. This evidence has been carefully dissected and does not suffer from any statistical bias.

Individual evidence also points to the success of these programs. Take a young unskilled offender, provide him with a marketable skill, and this gives him an alternative to crime when he is released back into society. To quote an offender who benefited from one of the programs run by the private company PRIDE in Florida: "I have developed a new sense of direction towards a productive life. It was the push in the right direction that I needed."

Criminologists are agreed that the most important influence on re-offending is whether the ex-prisoner secures a job in the first few weeks of release. Prison industry programs help in three ways: First, they provide the offender with a marketable skill; second, the savings fund accumulated while inside can be used to help them through their first few weeks of freedom; and third, some of the companies involved will provide the offender with a job upon release.

Part of the appeal of these schemes is that they are profit-making. For the companies involved, prisoners are a flexible work force, providing them with labor during holiday periods and over weekends. Once training has been given, the company will retain staff because they are valued employees.

Most workplace facilities are located within the perimeter of the prison, so the possibility of escape does not arise. In any case, evidence shows that most prisoners are on best behavior in order to retain their places in the program. The nationwide study made by the University City Science Center found that work programs have been accompanied by a fall in disciplinary offenses (Grant G. Grissom, *Impact of Free Venture Prison Industries Upon Correctional Institutions*, University City Science Center, January 1981).

Mr. Bidinotto's hostility to what he regards as soft-options for criminals is based on his image of the typical criminal as a violent fiend. In any

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prison system the majority of inmates are non-violent offenders. Also, there are large numbers of remanded prisoners—people who have not been convicted of any offense. Criminals are as diverse as the crimes that they commit, and there is little point in presenting a caricatured stereotype: the rogue immune to any type of reform process.

Nor is there much to be gained from retributive spleen, from complaining about more relaxed regimes in prisons. It is no great surprise that prison inmates—just like other folk—do not react well to being oppressively governed. Private enterprise managers of U.S. prisons are known to maintain very soft regimes inside their prisons: Prison guards are known as correctional staff and wear T-shirts rather than uniforms. They do this, not from any heinous liberal motives, but because it makes the prison more tranquil, cuts costs, and helps the company to attain the recidivism targets written into its contract with the state government.

There is a growing realization on both sides of the Atlantic that prisons have so far been a failure. Mr. Bidinotto's rather depressing solution is to build more of them. A more imaginative solution would be to make prison work the basis of the whole system.

NICK ELLIOTT
London

Mr. Bidinotto replies:

Mr. Elliott disputes the "image of the typical criminal as a violent fiend," arguing that "the majority of inmates are non-violent offenders." This is untrue. Due to prison overcrowding, most non-violent offenders are given probation or "alternatives to incarceration"; most prison beds are, in fact, reserved for dangerous and chronic felons. To repeat an example from my series, the Massachusetts Department of Correction (DOC), whose policies typify those around the nation, concedes "the fact that 85 percent of the DOC inmate population has a present or past violent criminal history."

He contends that prisons are "a failure." But that depends on what one intends them to accomplish. My main argument for imprisonment was neither retribution nor even deterrence: it was incapacitation. One hundred percent of those behind bars are prevented from committing other crimes against those on the outside—a perfect rate of success. A Federal study I cited found that the average state prison inmate, while free, had been committing 187 crimes per year, at an estimated cost to society of $430,000 per criminal. Putting just 1,000 more criminals behind bars for a year would have averted about 187,000 crimes and saved society over $400 million, net.

He is upset with my dismissal of various "prison work" programs. These, he says, provide a young offender "with a marketable skill." Despite his protestations to the contrary, that's just another way of saying that unemployment causes crime—a claim I rejected in Parts I and III. A causal relationship between unemployment and crime is indeed present: *criminality causes unemployment.* The typical criminal, who "is at heart antiwork" (as Stanton Samenow puts it), isn't going to be enticed away from the fast buck of a drug deal or burglary by what he views as the "trap" of a 40-hour work week.

Mr. Elliott cites a California work program which, he claims, has measurably reduced inmate recidivism, even after carefully controlling for "statistical bias." But is that true? Invariably, the worst, most dangerous inmates are screened out of such programs. Measuring the recidivism of the *select group* allowed to participate always gives glowing, but biased, results. That's no doubt the case here. Otherwise, we'd have to believe that TWA is indiscriminately hiring the full range of prison inmates, from rapists to murderers, to man its ticket counters.

Likewise the study by the University City Science Center: we've heard it all before. Exhaustive research (such as that reviewed in Wilson and Herrnstein's *Crime and Human Nature*) indicates that work programs make no real difference in reducing recidivism rates. Upon review, occasional studies claiming otherwise reveal a variety of self-serving methodological biases.

To be sure, recidivism isn't 100 percent. So there are always individual "successes" in such programs—just as there are criminals who claim to have been "reformed" by finding a good woman, religious inspiration, or some other positive influence. But whether such influences will work depends upon the prisoner's receptivity, his own earnest desire to change.

Regrettably, most do not. Despite years of such programs, a new Bureau of Justice Statistics

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(BJS) study of 108,580 released inmates found that over 60 percent were rearrested within three years. A 1988 report for the BJS summed up: "By the end of the 1970s, the vast bulk of research criticized the effectiveness of rehabilitation programs for criminal offenders . . . [T]here can be little argument that, empirically, rehabilitation has not worked."

It all comes down to one's view of human nature, particularly, the nature of the typical criminal. I've cited in my series abundant evidence that the criminal chooses to be predatory in his outlook and values. If so, there's simply no way to "rehabilitate" him without his compliance. To suggest otherwise is to embrace some form of determinism. And like other correspondence my series has generated, Mr. Elliott's letter reveals that sympathy for the free market system does not necessarily rest on consistent "free will" premises concerning human nature.

Another theme arises in a few critical responses to my crime series. Some seem to forget that the government's very reason for being is to protect our individual rights against *any* initiation of force, fraud, and coercion. In making cases against the dangers of an unchecked government, they've lost sight of the very danger government was established to confront: the danger of criminals in our midst.

Today, by any reasonable gauge, criminals pose a far more immediate and serious threat to most of us than do our government officials. At their worst, American officials must operate under many legal constraints and face political accountability, while individuals usually have considerable legal and political recourse against their abuses. Criminals, however, now operate with virtual impunity and pose increasing risks to individuals, who have little legal protection against them.

Some free marketers have lost all perspective about such things. When U.S. officials committed a petty burglary against political rivals, it was seen as such a scandalous abuse of power that even a President was ousted. Yet while constantly citing such marginal incidents as evidence of the imminent peril to our rights posed by government, many advocates of liberty remain utterly mute about the three million reported burglaries committed by criminals against private individuals in 1988.

Let's be sensible. Having to pay taxes, predictably and non-violently, for a hodgepodge of programs both good and bad, isn't remotely equivalent to being unpredictably confronted by some sociopath wielding a sawed-off shotgun and demanding money, or awakening to the sound of a burglar's footsteps downstairs. Facing the prospect of military conscription with a variety of legal options at your disposal is not remotely as horrifying as boarding an airliner with a terrorist hijacker on board, or having your child kidnapped from the sidewalk by a serial killer.

We lose all credibility with the American people when our abstract concerns and fears are so disproportionate and so removed from the very real threats they see at hand. How can they take seriously those who ignore the pressing problem of violent crime, while railing against, say, the Federal postal monopoly? Agreed, that monopoly is a costly, unjust, and unnecessary imposition on us all. But in all honesty, who poses a greater danger in one's neighborhood: the postman or the pedophile?

No one familiar with my work can contend that I've failed to speak out against the threats posed by unconstrained government. We must continue our vigilance against all efforts to unleash it. But realistically, the threat of dictatorship still remains distant and hypothetical. Such is not the case with the threat of crime, a clear and present danger in our midst. Through what distorting lens, then, do many alleged champions of individual rights view a largely benign government as a greater menace to its citizens, than those cold-blooded predators whom it was constituted to pursue and punish?

I would be gratified if "Crime and Consequences" could help to change such perspectives and public perceptions about this vital issue.

ROBERT JAMES BIDINOTTO
New Castle, Pennsylvania

To the Editors:

I agreed with almost everything in Robert James Bidinotto's stunning three-part series on our criminal justice system, but I do have two criticisms. One concerns his setting up free will as being diametrically opposed to determinism (*The Freeman*, July 1989, p. 261). The philosopher David Hume showed in 1739 (*Treatise of Human Nature*, Book II, Part III, Sections 1 and

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2—"Of Liberty and Necessity") that free will is not only not incompatible with determinism, but actually depends on it, for exactly the same reason Mr. Bidinotto stated that "human volition, then, isn't an affront to the law of causality: it's an instance of it" (same page as above).

Hume's arguments were reiterated and expanded upon in 1939 by Moritz Schlick (*Problems of Ethics*, translated by David Rynin, chapter VII—"When is a Man Responsible?") to include criminal justice, and constitute what is known as "the Reconciliationist" position (reconciling free will with determinism). Both Mr. Bidinotto and the Objectivist philosopher David Kelley, whom he referenced in Part I, are confused on this issue. Ironically, Mr. Bidinotto conceded that he does indeed believe both in determinism and free will in the second paragraph of Part III when he stated ". . . Aristotle's point about causality applies: the nature of an entity *determines* what it will do" (my emphasis). Essentially, the Reconciliationist viewpoint is that, yes, everything is determined, but to have one's actions determined by one's own atoms, one's own molecules, one's own cellular structure and neuronal circuitry, one's own brain, i.e. *oneself*, is really just another way of saying that one has free will—free in the sense that no external coercive force is involved—free to behave according to one's own nature. I refer the interested or unconvinced to Schlick's essay.

My second criticism is of Mr. Bidinotto's unsupported statement that "in cases of pre-meditated murder in which there is no question of guilt, it [capital punishment] should be the *standard* sentence" (*The Freeman*, September 1989, p. 348). As far as I'm concerned, society is justified in using only that amount of force necessary to protect itself, i.e., a sentence of life imprisonment without possibility of parole. I consider capital punishment to have a brutalizing effect on society. I have no desire for it, and don't wish to have a State-appointed executioner killing in my name.

HAROLD KYRIAZI
University of Pittsburgh

Mr. Bidinotto replies:

Dr. Kyriazi did not define his terms, so I'm not sure I grasp the nuances of his position. If I interpret him correctly, he believes something like the following:

"Causality" and "determinism" are interchangeable concepts. The free will of human nature can be reconciled with both of these; but to do so, we must redefine our terms. "Human nature" must be defined so narrowly as to include only physical attributes, such as our atoms, cells, and biochemistry. And "free will" must be defined to mean only the independence of these internal bodily attributes from external forces. This biological determinism is apparently what he means by "being free to behave according to one's own nature."

By contrast, I defined "free will" as "the premise that the individual can make some primary, irreducible choices about his thoughts, feelings, or actions." I argued that free will is a special instance of "causality," and hence compatible with it. I also argued that "determinism"—the theory that all human thoughts, feelings, or actions are necessitated by antecedent factors—is the logical antithesis of "free will."

In essence, Dr. Kyriazi shrinks the traditional notion of "free will" so as to fit within the narrow confines of determinism. I argue that the traditional notion of "causality" must be expanded so as to admit free will.

Our disagreement hinges on whether "causality" is the same thing as "determinism." Dr. Kyriazi insists on using the two terms interchangeably. I argue that causality need not imply determinism—*if* volition itself is a primary cause. Thus, when I wrote that "the nature of an entity determines what it will do," I was not implying any link between "causality" and "determinism." By emphasizing that human nature *includes* free will, I was arguing quite to the contrary.

As I wrote in Part I, equating "causality" and "determinism" stems from thinking of causality *only* in mechanical, "billiard-ball" terms. Note that Dr. Kyriazi's description of "oneself" consists exclusively of *physical* attributes: atoms, molecules, cells, neurons, the brain. This narrow, reductionist view of human nature excludes *volitionally directed awareness* as a primary, irreducible cause of subsequent human action.

Thus Dr. Kyriazi's "free will" is not free at all. By his view, man is enslaved not to external social forces, but to inner biological ones. To be determined exclusively by atoms, molecules, cells, neurons, and the physical brain is to *be-have*, not to

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act. His view is no "reconciliation" of free will with determinism: it simply rejects the former for the latter. To take his position seriously, one would have to conclude that Dr. Kyriazi had no choice about the conclusions he has expressed: his biochemistry made him do it.

Finally, regarding capital punishment. By "using only that amount of force necessary to protect itself," society would be rejecting the goal of justice, and saying that its *only* aim in sentencing is *future* public safety, by incapacitating the offender from committing other offenses.

While my *primary* argument for imprisonment is incapacitation of the career offender, I don't want to imply that such goals as retribution (justice) and deterrence are irrelevant. If we sentence solely according to the presumed future threat a criminal poses, instead of commensurate with the seriousness of his past crime, there could be no justice in the system. Sentencing would have no relation to the offense committed.

Retributive justice does not simply make victims and survivors feel better. It constitutes the premise that the level of punishment must fit the severity of the crime. This does not mean a literal "eye for an eye": society need not sink to the specific tactics of the criminal. But it does mean that society recognizes gradations of evil, and reacts accordingly.

In a society whose ultimate premise is that the individual life is an end in itself, pre-meditated murder is a crime in a class by itself. It negates the highest end of civil society: the irreplaceable individual life. Society would certainly be safer by locking up a murderer for life (assuming "life" really meant "life"). But a life term in prison still allows the murderer a multitude of values, options, and experiences his victim will never know. And in many cases, it prevents the victim's survivors—who are also crime victims—from ever burying their pain and resuming their lives.

To deny the sentence of capital punishment for murder, then, is to deny the very principle of fitting punishments to offenses. On what grounds can we uphold that principle of equity for lesser offenses, if we dismiss it for the most serious of crimes?

Far from brutalizing society, capital punishment for wanton murderers is society's way of affirming the supreme value of *innocent* life—and the existence of a class of irredeemably evil acts. It is a way of announcing: "We respect innocent life so much, that we won't tolerate those who presume the right to take it. They must be prepared to pay with their lives for those they take."

RJB

Note: Copies of the special "Crime and Consequences" reprint are still available—single copies, $3.00 each postpaid. To order, contact The Foundation for Economic Education, 30 South Broadway, Irvington-on-Hudson, New York 10533.

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A REVIEWER'S NOTEBOOK

The Midnight Economist

by John Chamberlain

Professor William R. Allen, who for ten years has been giving economic instruction to thousands of listeners over 200 radio stations, calls himself the Midnight Economist. He has collected his broadcasts, along with some other essays, in a book called *The Midnight Economist: Meditations on Truth and Public Policy* (San Francisco: ICS Press, 332 pages, $12.95 paper). Milton Friedman, in a wise introduction, notes that Allen's genius is for bringing into the open the elementary principle involved in an issue without being hortatory about it. Friedman marvels at Allen's versatility, the wide range of problems and issues that he covers. We can join Friedman in his admiration.

In addition to being instructive, Bill Allen is a lot of fun. He professes to giving shelter in his office to two mice. One goes by the name of Karl. The other is called Adam. Karl doesn't like economists. They are too gloomy with their eternal insistence on scarcity. Adam humors Karl. He defends economic truth by expressing a general sympathy for Karl's "sickness." Karl has been snarling about the concept of market equilibrium and announcing that economists "want equilibrium at any price."

"You may be sick for wrong reasons," says Adam. "We don't want equilibrium at any price; rather, we want a price at which there is equilibrium. And we want an equilibrium price, not because that will solve all problems, but because it generally avoids making a hard life still harder."

Karl, not really listening, snaps "we mice of sensitivity and compassion want government to make things better. One way is to stipulate fair prices."

It takes Adam Mouse, reasoning like Adam Smith, a little while to make Karl Mouse see the connection between unhappiness and uncleared markets. But Adam Mouse gets there because he has common sense on his side.

Karl Mouse accuses Adam of having no soul. But Adam has been "blessed with companionship of my rabbit Bunnie and my dog Winnie." Neither Bunnie nor Winnie add to the Gross National Product, but they contribute to happiness. "All our cleverness and wit," says Allen, interjecting at this point, "all our tools and technology, will leave us poor, indeed, a disgrace in the eyes of the Deity, as long as we lack the goodness and grace and gentility of Bunnie Rabbit and Winnie."

When he is not listening to his two mice, Allen is concerned with general economic dumbness. His midnight commentary assails as "mythology" such statements as "the minimum-wage laws raise the income of the poor," or "government jobs programs increase employment," or "tariffs increase domestic employment and wages," or "we could have enough of everything if we were fully to exploit our fantastic productive power." Our Congress spends most of its time trying to put 20 separate "myths" into new laws that will become drags on our economy.

A few states—Connecticut is one, New Hampshire is another—frown upon the income tax. Allen finds it significant that the states that grow most rapidly have the lowest level of income tax and property tax per person and the highest level of per capita sales taxes.

The proof of the pudding is in the record. "After New York lowered its progressive income tax

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rates in 1977," says Allen, "its economic growth increased and its unemployment fell in relation to the national average." Tax cutting, Allen concludes, is not a panacea. "But higher income and property taxes certainly are not a long-run road to prosperity—and since 1980 such state and local taxes have been rising rapidly."

Allen finds our Latin American policies to be mainly stupid. There have been calls for a Latin American Marshall Plan. But Europe in the late 1940s and early 1950s bore little resemblance to the Latin American circumstances of the 1980s. Anyway, contrary to nearly universally held mythology, the Marshall Plan was not a significant economic factor in European postwar recovery. It was, says Allen, basically a political strategy in economic clothing—a statement of intent to preclude further Russian advance in western Europe.

A lot of the Allen columns are pure historical exposition. He tells the story of the Roman Emperor Diocletian, who minted so many new coins that inflation from a superfluity of metal worked as do the printing presses of modern governments.

As I write this review, the homeless are descending upon Washington to demand government support of new building programs. Allen reminds us that rent control has greatly diminished financial incentives to build new housing. "Substantial homelessness," says Allen, "is manmade. And men perversely make it mainly with rent control." □

PROTECTIONISM
by Jagdish Bhagwati
The MIT Press, 55 Hayward Street, Cambridge, MA 02142 • 1988
168 pages • $16.95 cloth

Reviewed by Russell Shannon

In recent years, some economists have been lured away from the profession's traditional attachment to the principles of free trade. Instead, they advocate "strategic trade policies" in which governments subsidize favored domestic firms to help them gain an international advantage.

However, one who hasn't lost his moorings, Jagdish Bhagwati of Columbia University, has written a strong defense of the laissez-faire line. Although some passages in his book are a bit cryptic, he generally avoids technical jargon. Indeed, the book is a delight to read, for in addition to being salted with Bhagwati's wisdom, it is peppered with his wit.

Bhagwati begins by discussing the growth of trade and economic development since World War II. Under the auspices of the General Agreement on Tariffs and Trade (GATT), several series of multilateral negotiations have dramatically reduced tariff barriers.

The author poses an intriguing question: does economic growth cause trade—or vice versa? In part, the answer depends on one's point of view. From the perspective of *macro*-economics, the chain of causation runs from growth to trade, for, as people become more prosperous, they tend to purchase more imports.

In the context of *micro*-economics, however, the relationship is reversed: opening up trade (as the U.S. and Canada have recently done) permits increased specialization which yields more efficient use of resources, spurring economic growth and raising living standards. And since economic growth makes it easier to adjust to problems caused by increasing imports, it becomes easier to strike down the barriers which inhibit trade. In the author's felicitous phrase, we have a "virtuous circle" of tariff reductions, trade expansion, and economic growth.

With the success of GATT, protectionists have had to resort to new tactics. Although their arguments are generally fallacious, they often have a convincing ring. Just as it appears that the sun revolves around the earth, so too many people with a myopic economic outlook see only the job losses that result from the competition of imported goods. It takes a broader view to understand that consumers benefit from the lower prices that free trade brings, that flourishing export industries provide new job opportunities, and that the overall benefits of free trade swamp the losses.

Capitalizing on the failure of many people to take this broader view, protectionists have argued that we should impose tariff barriers to offset similar restraints imposed on our exports by foreign countries. Bhagwati points out, however, that as far back as Adam Smith, economists have spurned this approach on the grounds that the harm outweighs the good.

Unable to rely on tariffs to achieve their ends,

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protectionists have advocated quotas and "voluntary" export restraints to curb imports. Such nontariff protection, Bhagwati notes, is usually "porous," since foreign producers can usually devise ways to evade it by relocating facilities to other areas (as Hong Kong producers have shifted apparel production elsewhere) or by slightly altering their products (as the Japanese have switched to larger automobile models in the face of export limits). Yet we still have a distortion of resource use which violates the fundamental principles of sound economics.

Often, American producers complain that their foreign rivals are being unfairly subsidized or are selling their products below cost. Yet we, too, often subsidize our producers (such as farmers and the merchant marine), and as Bhagwati caustically notes, forbidding all producers from selling below costs would effectively prevent post-Christmas sales!

Bhagwati is encouraged by the fact that our government's executive branch has generally taken a pro-trade stance and that in recent years it has been particularly emphasizing the need to open up foreign markets for agricultural products and services, items for which the U.S. has a comparative advantage. However, there is also a dark side to the stress on export markets.

Some people contend that we should have trade balances with each and every country, and even in specific items such as textiles. Yet no one would suggest that a nurse should maintain a trade balance at her local supermarket by checking the temperature and blood pressure of the clerk who runs up her bill. Nor do we expect Maryland to have a trade balance with Oklahoma. Is anyone alarmed about our banana deficit? Then why should a deficit with Japan alarm us? We do, after all, have offsetting surpluses with such countries as The Netherlands, which is as it should be.

Finally, Bhagwati rejects the argument that "manufacturing matters." We need not, he notes, rely on manufacturing to be technically progressive; just look, after all, at the many improvements in medical services. Nor is it true that only manufacturing jobs are character-forming. Is a steelworker morally superior to a dentist?

Yet poking fun at these arguments may not suffice to deflate them. Bhagwati argues that, if we want the idea of free trade to triumph over the pressure of special interests, we must reform our institutions. For example, when the International Trade Commission investigates charges that foreign firms are dumping products in our markets, it considers only the harm being done to domestic firms. Bhagwati suggests that the Commission look at both the costs and the benefits of providing relief to our firms. Taking a more balanced and reasonable approach would likely result in fewer barriers.

So long as some economists can present such lively arguments in defense of free trade, there is reason to hope that we can turn back protectionist pressures that would greatly reduce all the world's living standards. □

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